

## **Section III Asset Management**

### **Chapter 3**

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### **General Loan Oversight**

#### **3.0.0**

#### **Introduction**

This chapter addresses details of loan servicing for projects insured under the Section 232 Program covered by this Handbook, and the related necessary actions for the Project (consisting of the Borrower, Operator, Master Tenant (if applicable) and Management Agent), Servicer and the Office of Residential Care Facilities' (ORCF) Account Executives (AE). For the purposes of this chapter, the term "Servicer" means the primary servicer responsible for servicing the mortgage loan, whether such party is the originating Lender or third party servicer for the originating Lender.

ORCF provides asset and risk management of all Section 232 insured projects; however Servicers must also provide routine reviews of their portfolio, which includes quarterly and annual reviews of financial performance as discussed in Asset Management, Chapter 4, as well as special reporting to the AE when a project's performance is at risk. This chapter provides guidance regarding performance benchmarks for each project, and also regarding the necessary actions to be taken by the Servicer, AE and project in specific circumstances during the life of the FHA insured mortgage.

Many tools and resources are posted on the Section 232 Program website, to include submission checklists, average processing times, and other helpful information that can provide supplemental guidance to this Handbook.

## Section 3.1

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# Servicing and Monitoring of Construction Projects

### 3.1.1

#### Introduction

This section provides ORCF asset management guidance for Section 232 and 241(a) mortgage loans that include lease-up of units (new construction, substantial rehabilitation, blended rate, and Section 241(a)) – Construction Projects.

**Asset Management Principle.** Early and continuous involvement of asset management staff with construction projects is essential due to a) the elevated business risk of failure associated with leasing-up projects; and b) if applicable, the varied risks of performing construction in direct proximity to residential health care.

A construction team, including two AEs in Asset Management, will work closely with the Production staff to ensure a seamless transition between the two divisions. These two construction AEs will be assigned to all projects until the project is performing as projected and deemed stabilized in the market.

When possible, the monitoring of construction projects is initiated by ORCF asset management staff prior to a project opening and is continued until a project demonstrates self-sustaining operations. It has been HUD's experience, that the critical start-up period demands proactive collaborative monitoring by the Borrower, the Lender, Operator, Management Agent, and ORCF. Even after a project has attained self-sustaining operational status, its success is not guaranteed and it must be monitored carefully until it has permanently established itself in the marketplace.

### 3.1.2

#### Organization and Responsibilities

Proper asset management of Section 232 and 241(a) construction related healthcare projects requires a team approach, and a clear understanding among assigned staff, of the roles and responsibilities of the parties involved. ORCF will assign an AE for each project to serve as the primary facilitator, but the "start-up" requirements of construction projects may require the participation of the ORCF Underwriter, Closer, Construction Manager, Appraiser and others as necessary. Additionally, the assigned closing attorney from the HUD Office of General Counsel (OGC) may also need to be involved. The Lender and the Borrower must be part of the team as well. Also, for projects that were originated under MAP guidelines by the Office of Multifamily Housing field offices, representatives from the originating HUD Multifamily office may also need to participate.

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### 3.1.3

## Loan Committee Presentation and Initial Closing

To ensure that the AE Construction team has the opportunity to fully appreciate the issues, objectives and risks of construction loans as described above, the AE's assignment will begin with attendance and participation in the project's loan committee presentation. The following summarizes the usual asset management process through initial closing:

- The AE construction team will participate in all official Loan Committees surrounding the construction projects with the ORCF Underwriter.
- The AE attends the Loan Committee presentation to ensure familiarity with all the aspects of the new loan.
- Upon issuance of a Firm Commitment, the Closer staff facilitates any functions necessary for the Initial Closing. The AE will work with the Closer and/or the Construction Manager as requested and as appropriate.

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### 3.1.4

## Asset Management Functions after Initial Closing

The AE's activity after Initial Closing varies according to the type of loan, which determines the asset management lead-time provided by construction.

A. In the case of a Section 232 construction loan where there are not existing operations that will continue during construction (new construction and some substantial rehabilitation projects), the project's construction phase will typically consume many months, during which time the AE's duties will be minimal. When a project of this type reaches the point of 70% completion (calculated as a percentage of construction draws), the AE will be alerted via email by the Construction Manager, and the AE will then commence pre-operations asset management functions, including facilitation of the "Pre-Operations Meeting".

1. **Pre-Operations Activities.** Key to a successful start-up is a well-orchestrated transition from the construction to business operations phases. During the construction phase, the AE may need to intervene in unusual circumstances when alerted by the Closer or Construction Manager; however as the project opening approaches, the AE becomes the facilitator of important project tracking activities. When this type of project is scheduled to open within the following quarter, the AE will begin to work closely with the Lender, project participants and ORCF colleagues to help assure a successful transition and business start-up.
  - a. ORCF Staff Communications. The AE, the Construction Manager and the assigned Closer should communicate after Firm Commitment to ensure that all parties are aware of the project assignment. If project issues arise, the AE will participate as necessary to ensure appropriate resolutions. To keep the AE

informed about construction progress, the Construction Manager will send an email notification to the AE when a new construction project reaches 50% completion, and again when the project reaches 70% completion.

- b. Pre-Operations Meeting. When a new project reaches 70% completion, the AE will arrange and facilitate the Pre-Operations Meeting conference call. The general purpose of the call is to promote the timely accomplishment of all operating preparations necessary to meet the scheduled business opening date and assure a smooth start-up. Prior to the meeting, the AE will collect project status information as required and determine the appropriate participants and agenda for the meeting. The AE will provide the Lender representative with a meeting announcement and agenda, along with the meeting materials, so that the Lender can distribute materials to all parties in advance of the scheduled meeting date.
  - i. Participants shall include the Borrower, Operator and/or Management Agent (if applicable), the Lender representative, as well as ORCF and Multifamily Housing staff, as determined by the AE.
  - ii. The agenda will cover the following:
    - 1. Introductions
    - 2. Pre-opening checklist, which the Borrower and Operator can use for guidance during start-up (Please see the Section 232 Program website,)
    - 3. Borrower's summary of the marketing plan and current project status
    - 4. Status of all state permits, i.e. Operating License, Medicaid/Medicare certifications
    - 5. Discussion of the Initial Operating Deficit (IOD) tracking worksheet (Please see the Section 232 Program website)
    - 6. Proper registration in the business partner system
  - iii. Project issues may be discussed and resolved, or deferred to later meetings. In the case of Borrowers, Operators or Management Agents that are unfamiliar with ORCF requirements, it may be advisable to defer full discussions until later meetings as determined to be necessary. A suggested draft Pre-Operations Meeting agenda is provided on the Section 232 Program website.
- c. Project Monitoring Strategy and Action Plan. Upon completion of the Pre-Operations Meeting, the AE should be able to 1) make an initial risk assessment, 2) articulate a consensus strategy for resolving any existing issues, and 3) define an action plan for monitoring the progress on further activities required for the project opening. Any conclusions, agreements, follow-up assignments, information requests, additional meetings schedule, etc., should be reiterated in writing for all project team participants and also recorded in the HUD iREMS system.

## 2. **Ongoing Asset Management Activities (After Project Opening)**

- a. General. The AE will monitor the project's performance in accordance with the plan established, and will meet with project participants as scheduled. In the event that start-up issues arise or the project fails to meet the underwritten projections, the AE will intervene as necessary and will seek supervisory guidance and/or engage the ORCF Risk Mitigation Branch (Turnaround Team) as appropriate.
- b. IOD tracking. The AE must approve any releases of IOD funds and will seek to ensure that the funds are used judiciously by carefully tracking project performance and the availability of remaining funds. Further information regarding IOD funds is provided in the Escrow Accounts section of this chapter.
- c. IOD Tracking Worksheet. A project-specific IOD tracking worksheet will be generated based upon the assumptions regarding the project's lease-up used in sizing the project's IOD escrow and placed in the IOD Library in the New Construction folder in SharePoint. The AE will forward the IOD Tracking Worksheet to the Lender to be forwarded to the Borrower with other materials for the Pre-Operations Meeting. Borrowers will be instructed to complete and submit the Worksheet on a monthly basis. The Worksheet will provide the AE with the project performance documentation and justification necessary for releasing funds from the IOD escrow account.
- d. IOD Tracking without the IOD Tracking Worksheet. In certain instances, an IOD Tracking Worksheet may be unavailable. In those cases it is incumbent upon the AE to either 1) generate a tracking worksheet based on underwritten projections, or 2) establish project-specific written agreements with the Lender and Borrower regarding a plan for utilization and preservation of the IOD funds.
- e. Operating Reports. The AE needs regular project performance data to assess the overall health of the project. It is essential that the AE specify exactly what project operating reports will be required. In the instance where the IOD Tracking Sheet is available, its submission will provide the AE with a trended summary of monthly occupancy, revenue and expenses. The AE might also require that periodic financial statements (e.g., Balance Sheet, Statements of Profit/Loss, Cash Flows, Retained Earnings, Computation of Surplus Cash, AP and AR Aging Analysis) be submitted depending on how the project is performing. The HUD Monthly Accounting Reports (MAR) can provide valuable data as well.
- f. Performance on surveys, inspections and certifications. Projects must survive initial regulatory scrutiny. Skilled Nursing Facilities (SNF) in all states undergo initial CMS compliance surveys in addition to Medicare and Medicaid certification reviews. Assisted Living Facilities (ALF) and Board & Care Facilities (B&C) are inspected in accordance with respective state rules. Issues with surveys and inspections can lead to lost or delayed revenues at a point where a new project's financial base is fragile. The AE must communicate closely with Borrowers and Operators to remain abreast of progress on early regulatory reviews.

- g. iREMS updates to the project record. The AE must carefully track and summarize project start-up status in the Risk Management section of iREMS. Monthly entries are appropriate.
- h. Achievement of Self-sustaining Operations. A project of this type attains self-sustaining performance when it demonstrates six (6) consecutive months of:
  - i. Debt Service Coverage Ratio equal or greater than 1.0 (including funding of all required escrows)
  - ii. Timely and full mortgage payments on a Finally Endorsed loan
  - iii. No regulatory issues

When self-sustaining performance is acknowledged by the AE, it must be recorded in iREMS and the status should be changed to “Not Troubled”.

B. For Section 232 and 241(a) construction loans where existing operations will continue during construction (including blended rate, and some substantial rehabilitation projects), the AE must begin asset management duties immediately after Initial Closing.

1. General. On these loans, the element of construction immediately raises the risk to the project due to resident, visitor and staff safety issues. Furthermore, renovating existing projects often uncovers project issues that were unknown at the time of underwriting, and the scope, duration and cost of construction sometimes changes. Those unexpected changes may raise asset management issues that require the AE’s attention.
2. Timing. Upon Initial Closing of the loan the AE will promptly initiate project communications and commence project monitoring and servicing functions. There is no lead-time for construction, nor are there “Pre-Operations” activities required. As indicated in Section 3.1.4, the AE’s participation at the LC review of the project proposal should provide prior knowledge about the project. The AE should be prepared for the uncertainties of renovation and the potential impact that construction plan changes may cause for the resident population. Issue resolutions will typically involve collaboration among the Construction Manager, UW, and Closer, along with the AE.
3. Initial Meeting. The AE will schedule to meet with the Lender, Borrower, and general contractor (if appropriate) and establish a communications routine and schedule. An initial conference call meeting involving participants determined by the AE, shall cover the following matters:
  - a. Introductions
  - b. Borrower’s summary of the plan to continue operations during construction
  - c. Review of issues and plans for resolution (significant issues may require additional follow-up meetings for resolution)
  - d. Review the status of all permits (e.g., Certificate of Occupancy, operating license, etc.)
  - e. Discussion of working capital and IOD tracking if applicable

- f. Confirmation or discussion to ensure registration in the Business Partner Registration System
  - g. Assess the Borrower's and/or Operator's knowledge of ORCF requirements and provide guidance accordingly
  - h. Status of progress toward final closing
- 4. Project Monitoring Strategy and Plan. Upon completion of the conference call, the AE should be able to make an initial risk assessment and articulate the consensus strategy for resolving any existing issues and for monitoring further activities required for opening. Any conclusions, resolutions, agreements made, follow-up assignments, the plan for follow-up meetings, etc., will be reiterated in writing for all project team participants and also recorded in the HUD iREMS system.
- 5. Achievement of Self-sustaining Operations. A project of this type attains self-sustaining performance when it demonstrates six (6) consecutive months of:
  - a. Debt Service Coverage Ratio equal or greater than 1.0 (including funding of all required escrows)
  - b. Timely and full mortgage payments on a Finally Endorsed loan
  - c. No regulatory issues
  - d. When self-sustaining performance is acknowledged by the AE, it will be recorded in iREMS and the Risk Classification changed to "Not Troubled".
- C. With projects that are approved for early commencement of construction, the AE will be alerted to the project by the Underwriter, and the Construction Manager will monitor the construction activities. If a Firm Commitment is issued, the AE will immediately initiate asset management functions. Similar to other construction loans, the AE will make an initial risk assessment, define a monitoring plan, specify reports requirements and document accordingly in iREMS.

After Firm Commitment, projects that have been previously approved for early commencement will thereafter be monitored in accordance with the asset management guidelines for the specific type of construction loan until the project attains Self-sustaining Operations (as discussed above).

### **3.1.5**

## **Monitoring and Lease-up Tracking Until Self-Sustaining Performance is Achieved**

ORCF monitors the "lease-up" of all Section 232 and 241(a) loans that result in additional beds being added to a market. The Construction AE(s) will monitor the lease-up projections outlined in the appraisal and communicate back to the Production team.

All Section 232 FHA-insured projects are governed by statutes, regulations and controlling documents. Borrowers and other program participants are obligated to comply with ORCF program obligations or be subject to program enforcement remedies. The assigned AE must ensure all participants have been informed relative to their program obligations.

Prior to the initial/final closing of a project, the AE will schedule a conference to review all pertinent matters regarding servicing of FHA-insured projects. A sample of the pre-closing or pre-occupancy conference agenda is available on the Section 232 website.



## Section 3.2

### Escrow Accounts

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#### 3.2.1

#### Introduction

- A. **Residential Care Facilities:** A FHA-insured Residential Care Facility will typically have one or more of the following types of escrow accounts (each one, hereinafter referred to individually, as an “Escrow Account” and collectively, as the “Escrow Accounts”):
- |                                  |                        |
|----------------------------------|------------------------|
| 1. Reserve for Replacement       | (Refer to 3.2.2 below) |
| 2. Residual Receipts             | (Refer to 3.2.3 below) |
| 3. Non-Critical Repairs          | (Refer to 3.2.4 below) |
| 4. Sinking Fund                  | (Refer to 3.2.5 below) |
| 5. Mortgage Reserve/Debt Service | (Refer to 3.2.6 below) |
| 6. Initial Operating Deficit     | (Refer to 3.2.7 below) |
- B. **Escrow Accounts:** Each Escrow Account has a specific purpose, but all such accounts are intended to protect the interest of the Borrower and FHA mortgage insurance fund. Escrow Accounts are either required by Federal regulations, Regulatory Agreements, contractual agreements established during the underwriting of a project loan or contractual agreements executed subsequent to an initial loan closing. The Escrow Accounts are required to be used for specific purposes as outlined in this chapter or in the escrow agreement. The disbursement process requires cooperation between ORCF, the Borrower and the Lender. This chapter sets forth the general requirements for the maintenance of Escrow Accounts and the procedures to request a withdrawal or disbursement from each of the accounts.
- C. **Pending Loan in Review:** If an existing FHA-insured project has a pending application for a 223(a)(7) loan refinance or for any other FHA program, the Borrower must disclose information on a pending loan application of any request for a disbursement from an Escrow Account. Large unanticipated withdrawal requests may affect the financial information required for ORCF to process the pending loan application.
- D. **Specific Escrow Requirements:** ORCF may determine that a requirement that applies to one type of Escrow Account is also applicable to another Escrow Account.

#### 3.2.2

#### Reserve for Replacement Account

- A. **Introduction and Applicability:** The Regulatory Agreement for projects financed with FHA-insured mortgages provides that the Borrower must establish and maintain an account to help defray the costs of replacing a project's capital items (the “R4R Account”). The R4R

Account is held as a separate account with the Lender or in a safe and responsible depository designated by the Lender. The Borrower is required to begin making deposits into the R4R Account on the date that the Borrower begins making payments to amortize the principal of the FHA-insured mortgage, or on such other date as may be approved by ORCF in writing. The monthly amount to be deposited in the R4R Account is set forth in the Regulatory Agreement which provides that the account is under the control of the Lender. Disbursements from the R4R Account, whether for the purpose of effecting replacement of structural elements or mechanical equipment of a project; to cure a mortgage default; or for any other approved purpose, may be made only with the prior written consent of ORCF (or under the provisions whereby HUD allows Servicers to review R4R releases outlined in this chapter). For HUD-held mortgages, the Secretary will exercise control over the R4R Account pursuant to the authority granted under the National Housing Act. The following are some of the key requirements for a R4R Account:

1. Separate Account. A R4R Account must be maintained as a separate account. The funds in the R4R Account may not be combined or commingled with other escrow accounts, including but not limited to, the accounts listed in Section 3.2.1 above, without the prior written approval of ORCF.
2. Interest Earned on Account. ORCF encourages and in some cases requires that interest earned on the R4R Account remain in the account. Interest may never be disbursed directly to the Borrower of a project or directly to any individuals associated with the Borrower. All interest earned must flow through the accounts of the project and must be disclosed on the project's accounting records.
3. Type of Account. Funds in the R4R Account and all Escrow Accounts must be invested in an interest-bearing account insured by the Federal Deposit Insurance Corporation, National Credit Union Association, or any United States of America insurance program.
4. Regulatory Agreement Not Modified. Nothing contained in this Section 3.2 shall be deemed to modify the terms and conditions of the Regulatory Agreement.

- B. **Major Movable vs. Realty Reserve for Replacement Funds.** ORCF no longer recommends that FHA-insured projects maintain two R4R accounts (major-movables and realty). If the project has two R4R Accounts, the Lender, with consent of the Borrower, may combine the two accounts into one account.
- C. **Qualified Repair or Replacement Expenses:** The purpose of the R4R Account is not to provide for a dollar for dollar ability to replace all building structural components and equipment as they wear out, but rather to provide a readily available source of capital to help defray the cost of replacing building structural components and equipment in the latter years of the project. The R4R Account shall not be considered as the primary source of funds for capital project repairs and replacements, but only as a supplemental source of funds. Borrowers should also maintain a repair, maintenance and/or replacement fund in the annual

operating budgets of Section 232 FHA-insured projects. The following are eligible uses for the R4R Account (the “Qualified Expenses”):

1. Capital items including, but not limited to:
  - a. Replacement of windows in the project.
  - b. Extensive replacement of kitchen and bathroom sinks and counter tops, bathroom tubs, water closets, and doors (exterior and interior).
  - c. Major roof repairs, including major replacements of gutters, downspouts, and related eaves or soffits.
  - d. Major plumbing and sanitary system repairs.
  - e. Replacement or major overhaul of central air conditioning and heating systems, including cooling towers, water chilling units, furnaces, stokers, boilers, and fuel storage tanks.
  - f. Overhaul of elevator systems.
  - g. Major repaving/resurfacing/seal coating of sidewalks, parking lots, and driveways of the project.
  - h. Repainting of the entire building exterior.
  - i. Extensive replacement of siding.
  - j. Extensive replacement of exterior (lawn) sprinkler systems.
  - k. Generally, the following items (previously categorized as major movables) are Qualified Expenses, provided that the price of an item is not less than \$500.00 each, and not a routine maintenance item: office/common area/unit equipment, appliances and furniture, nursing/patient care equipment, food service/laundry/housekeeping equipment and appliances, and maintenance equipment. The \$500.00 minimum may be waived if the scope of the replacement is considered to be extensive and replacement is done during the same time period – e.g. replacement of twenty refrigerators that are less than \$500 each.
2. For certain projects, capital improvements or enhancements to the project may be considered as a Qualified Expense. For example, individual air conditioning units may be added to a project that was not air conditioned when it was built; gutters and downspouts may be added where necessary; or an initial purchase of a personal or office computer and some associated software may be purchased. However, routine repairs, maintenance and service fees, such as internet fees, web hosting, software-hardware maintenance/updates, proprietary software/vendor fees and related expenses are not Qualified Expenses. Some improvements may be eligible if in the AE's judgment, the improvements would:
  - a. result in enhancing the mortgage security, including making the project energy efficient,
  - b. upgrade the project and place the project in a more favorable competitive position in the marketplace,
  - c. be necessary to comply with changes in local, state or Federal laws, and/or
  - d. not inordinately deplete the R4R Account.

**D. Non-qualified Expenses:** Items traditionally contemplated as ineligible expenses that may not be paid for with funds from the R4R Account include, but are not limited to the following maintenance items:

1. Repainting of interior areas of projects, including but not limited to, painting of residential units, hallways, community rooms, kitchens, offices and the like. A separate interior painting reserve for this kind of work may be established by mutual agreement and consent of the Borrower, Lender and ORCF. ORCF may consider releasing funds for interior painting when:(i) the project does not have sufficient operating funds to cover such expense; and (ii) the interior painting is major work, involving at least two (2) or more rooms (including common or residential areas).
2. Replacement or repairs of a part or a component of range burners, televisions, computers, routers, bibs, oven elements, controls, refrigerators, valves, wiring and the like.
3. Minor Replacements of dwelling unit air conditioning components such as fan motors and window unit compressors.
4. Minor repairs to central air conditioning and heating systems such as valve replacements and the cleaning of boiler interiors.
5. Minor roof repairs, including minor repairs to gutters and downspouts.
6. Minor paving or repairs.
7. Minor Caulking and sealing. However, caulking or sealing of the entire project to improve energy efficiency is a Qualified Expense.
8. Window and screen repairs.
9. Purchase of minor equipment, furniture, appliances or fixtures; that is, items costing less than \$500.00 – see Section 3.2.2.C.1.k, above.
10. Inspection/recharging/replacement of fire extinguishers.
11. Minor carpet or flooring repairs. However, carpet or flooring replacement of two or more units or the entire common area of a project is a Qualified Expense.

**E. Adequacy of Reserve for Replacement Account:** The Borrower must analyze the amounts in a project's R4R Account in the light of anticipated replacement needs (in certain cases ORCF may require that the Borrower perform an analysis of the account). A Borrower shall rely on its knowledge of the physical condition of the project, evaluations made by Operators or Management Agents, and physical inspection reports furnished by the Lender and by ORCF. If the Borrower's analysis indicates that it is necessary to increase the rate of

deposits into the R4R Account, the Borrower should contact the Lender to request authorization to increase the monthly deposit requirement.

- F. **Recommended Minimum Threshold:** Borrowers should strive to maintain a minimum recommended threshold equal to at least \$1000 per unit in the R4R Account. For example, the minimum R4R Account balance for a 100-unit project is \$100,000. The purpose of the minimum threshold is to ensure that funds are available for an emergency, such as a major roof failure or a water or sewer main break. Failure to maintain the minimum threshold could trigger a discussion by the AE with the Lender, and the Borrower to determine whether an increase in the deposit amount is appropriate given the reliance on the fund. If the account regularly falls below the recommended minimum, ORCF may decline to approve a request to withdraw funds from the R4R Account unless in an emergency situation.
- G. **Adjustments to Recommended Minimum Threshold.** The Borrower, Lender or ORCF may increase the recommended minimum threshold of \$1000 per unit under one or more of the following circumstances:
1. **Physical Condition.** Projects in less than very good condition, as evidenced by a recent REAC Physical Inspection Score under 60, may require larger balances.
  2. **Geographical Location.** Exposure to severe or unusual weather conditions, as well as the widely varying costs of repairs and replacements.
  3. **Immediate Replacement Needs.** The project is in good physical condition but an unexpected large capital need arises.
  4. **Changes in Replacement Items.** If non-traditional items, such as routine carpet replacement, are to become eligible R4R Account items, the minimum to be held in the account may need to be increased.
  5. **Unit Composition.** Projects with more larger-sized units typically require larger amounts in the R4R Account than projects with smaller units. For example, a project designed with more than one bed per housing unit would almost always require more reserves than a project with one bed per housing unit.
  6. **Urban vs. Rural.** Urban projects often require larger reserves than rural projects.
- H. **Three-Bid Requirements:** If a single Qualified Expense or contract to repair or replace an item is in excess of \$50,000, the Borrower is required to obtain three (3) bids or price quotes and must comply with the following:
1. Three (3) bids must be secured and a confirmation that bids were obtained from qualified independent bidders must be provided to ORCF and the Lender. Actual bids do not need to be submitted with a request to withdraw funds from the R4R Account, unless requested by ORCF or the Lender. However, the names of the bidders and the corresponding amount of each bid must be provided to the Lender and

- ORCF along with the name of the selected bidder or vendor (the “Bidder”). The Borrower must keep copies of all the bids on file for at least three years (3) from the date of receipt and make them available for ORCF staff to review. All Bidders (vendors, contractors or the like) must have all the appropriate credentials and applicable licenses, as are required by the local jurisdiction, to transact or conduct the business required by the bid.
2. If the lowest bidder was not selected, the Borrower must explain the reason for selecting the Bidder. For example, consideration may be given to the Bidder's reputation for quality workmanship, materials, and timely performance and to the urgency of the repairs.
  3. If a portion of the funds are due in advance of the work that is to be performed by the Bidder, a request to withdraw funds from the R4R Account must be submitted as set forth in Section 3.2.2 above, along with documentation, such as a copy of the executed contract, invoice or purchase order, to support the amount being requested in advance. The Borrower must also explain why an advance is needed. At the discretion of ORCF, the request may be granted on an installment basis depending largely upon: the scope of work completed; the remaining work to be performed; the availability of funds in the project's operating account; and what is provided for in the contract, invoice or purchase order with the Bidder.
  4. Failure to follow the bid requirements may result in ORCF's denial of the request to withdraw funds from the R4R Account. However, if the work commenced or was completed without three (3) bids and without the prior approval of ORCF, ORCF may still consider approving a request to use funds from the R4R Account if: (a) the work was performed in good-faith; (b) the Borrower provides a certification that any future work over \$50,000 will be submitted for bid; (c) the costs or expenses for the work was reasonable for the area in which the project is located.
  5. On a case by case basis, ORCF may waive the requirement to obtain bids for Qualified Expenses in certain circumstances. For example, ORCF may waive the bidding requirement: in cases of an emergency; where there is a lack of available vendors/bidders in the area that the project is located; or due to the very special nature of the Qualified Expense. Contact your AE for a waiver of the bid requirements.

#### **I. Withdrawals from the Reserve for Replacement Account**

1. Borrowers or Operators are to submit Reserve for Replacement (R4R) requests to HUD through their Servicer (with the exception of those that can be directly reviewed and approved by the Servicer, as described in Section 3.2.2.I.5). A checklist of required exhibits to submit to HUD for R4R requests will be available on the Section 232 Program website.
2. The Servicer is to receive the R4R requests, review them for completeness, accuracy and eligibility, and then forward them to HUD with a recommendation for approval



(with the exception of those that can be directly reviewed and approved by the Servicer, as described in Section 3.2.2 I, 5).

3. **Additional Considerations.** The following factors will be considered by HUD in processing a request to withdraw funds from the R4R Account (or any other Escrow Account listed in this chapter):
  - a. Whether the expense is a Qualified Expense, as defined in Section 3.2.2, or with respect to other Escrow Accounts, whether the expense is an eligible expense under the applicable account.
  - b. Adequacy of the funds in the R4R Account.
  - c. Bid requirements as described in this Section 3.2.2.H, if applicable.
  - d. If the project has an active or pending refinancing/financing application (i.e., 223(a)(7) or other loan program), the Borrower must disclose this information to HUD with the request to withdraw funds from the R4R Account.
  - e. If the submittal proposes remodeling, adding to, subtracting from, reconstructing, or demolishing a portion of the mortgaged project (as discussed further in Section 3.4.4 of this chapter), an environmental review as required by 24 CFR Part 50 will be conducted in accordance with Production, Chapter 7.

4. **HUD Processing Format.** ORCF recommends that the request to withdraw funds from the R4R Account be submitted via electronic mail in PDF format or as a MS Word File.

5. **Optional Lender Review and Delegated Approval of R4R Requests:**

In an effort to streamline operations, increase response times, and allow HUD staff to focus on more complex R4R or escrow review requests, there are certain requests that may be approved by the Servicer, as long as the below criteria are met. Pre-approvals, advances, shortfalls, mortgage payments, etc. must all be submitted to HUD for processing and approved only by the AE, and are not eligible for Lender approval.

This Lender/Servicer approval is not a requirement and is optional for those who agree to administer the review and approvals within the HUD and Section 232 guidelines.

- a. **Lender Approval Process:** A prerequisite for participation in this process is HUD approval of the Servicing Lender to participate in this delegated review. If a Servicing Lender has been approved by Multifamily Housing in accordance with their process related to delegated review of R4R requests, ORCF shall consider the Lender approved to perform delegated review of R4R requests for all residential care facility loan types (provided the specifics of the transaction meets the below criteria). If a Servicing Lender wishes to apply for approval solely to administer R4R Requests on Section 232 projects, the request must be submitted electronically to the ORCF Director of Asset Management. The request must include a revised Quality Control Plan

addressing the items in b through f below. HUD will retain responsibility for review of R4R requests in all cases where there is an identity of interest between the Borrower, the Lender, or affiliates of either.

- b. The request may only be for reimbursement requests on eligible replacement items that have already been funded by the participant.
- c. The R4R account balance must be at a minimum level of \$1,500 per unit after the release.
- d. If the R4R request is for a situation where there is a proposed remodeling, adding to, subtracting from, reconstructing, or demolishing of a portion of the mortgaged project (as discussed further in Section 3.4.4 of this Handbook), the R4R request is not eligible for this optional Lender review. Such proposals must be submitted to HUD for routine processing and approved only by HUD.
- e. All submitted reimbursement items must be only qualifying expenditures, as defined in Section 3.2.2 above, and as eligible and reported on the Funds Authorization (Form HUD-9250-ORCF) and Borrower Certification and Request Detail (Form HUD-9250A-ORCF).
- f. Servicer will review the request, determine eligibility, and may approve qualifying requests (as described above) by signing the form, noting their Name (also to include Title and Organization), Signature, City, State, and Date in the respective fields.
- g. Once completed, all Funds Authorizations signed by the Servicer must then be submitted electronically to the AE for their files, as well as entry into the HUD system. This must be received by the AE, within seven (7) business days of Servicer approval.
- h. ORCF will not surcharge or penalize Servicers for approved R4R releases, provided the instructions in this handbook, and on designated HUD forms were followed.

## **J. Special Requests.**

1. Request to suspend or reduce monthly deposits into the R4R Account. Generally a request to suspend or reduce monthly deposits will be considered only when the project is in good financial, physical and regulatory standing. The R4R Account balance must be equal to at least sixty (60) months of deposits. Monthly deposits cannot be suspended for more than 12 months at a time. The following items are required to be submitted to ORCF in connection with a request to suspend or reduce monthly deposits into the R4R Account:
  - a. Completed Funds Authorization;
  - b. Completed Borrower Certification and Request Detail;

If the request for suspension or reduction in the monthly R4R deposit is being requested because a project cannot currently fund the deposit, the Servicer and AE will conduct a meeting to discuss the financial situation, cash flow problems and any other concerns leading to this request from the project.



2. Borrowing funds to cover mortgage payments or operating deficits. In extreme cases, ORCF may consider a Borrower's request for a short term loan of funds from the R4R Account. The purpose should be related to a condition or circumstance beyond the normal control of the Borrower. A request for a loan from the R4R Account may trigger an enhanced analysis of the project. The following items are required to be submitted to ORCF in connection with a request for a short term loan of funds from the R4R Account:
  - a. Narrative explaining the proposed loan terms, expenses to be paid and the reason for the request (including an explanation of any outstanding ORCF and state compliance issues);
  - b. Completed Funds Authorization;
  - c. Completed Borrower Certification and Request Detail;
  - d. The three (3) most recent monthly financial statements for the project.

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### 3.2.3

### Residual Receipts Account

- A. **Definition:** During the life of an FHA insured mortgage, Residual Receipts are an asset of the Borrower held under the control of ORCF. If a Borrower is required to establish a Residual Receipts Account for a project, the requirement will be set forth in the Regulatory Agreement which will set forth the type of assets that are included in the definition of "Residual Receipts."
- B. **Calculation of Residual Receipts:** The Borrower should use Form HUD-93486 -ORCF Computation of Surplus Cash, Distributions, and Residual Receipts either semi-annually or annually (depending on the Regulatory Agreement for the project) to calculate allowable distributions and any amounts that may be due for deposit in the Residual Receipts Account. Instructions for completing the form are shown on the back of the form and the calculation for distributions must be included in the audited annual financial statements filed with HUD.
- C. **Depositing Residual Receipts:** Residual Receipts must be deposited in a separate Residual Receipts Account, except to the extent that the Non-profit Borrower's Regulatory Agreement may provide some limited right to retain Residual Receipts. Funds in the Residual Receipts Account may not be combined or commingled with other escrow accounts, including, but not limited to, the accounts listed in Section 3.2.1 above, without the prior written approval of ORCF. The Regulatory Agreement specifies when Residual Receipts are to be deposited into the Residual Receipts Account. The account is maintained with the Lender.
- D. **Holding and Investing Funds:** Funds in the Residual Receipts Account for all projects with FHA-insured mortgages must be invested and all interest earned on the investments must be credited to the Residual Receipts Account. Funds in Residual Receipts Account are to be invested and safeguarded by Lenders and Borrowers in the manner described in Section 3.2.2 of this chapter.
- E. **Qualified Uses for the Residual Receipts Account:** Borrowers may request disbursement of funds from the Residual Receipts Account for the following purposes:

1. To reduce operating deficits when legitimate cash flow deficits exist.
2. To make mortgage payments when a mortgage default has occurred or is imminent.
3. To make repairs or replacements to the project that are not covered by the R4R Account described in Section 3.2.2 above.
4. To provide additional project amenities such as air conditioning, a sprinkler system, fire or smoke detectors, or energy saving devices as well as office equipment such as computers and associated software.
5. For other expenses deemed necessary, and in the best interest of the project as determined by ORCF and the Lender. Generally, all expenses which qualify for reimbursement under the R4R Account may also be reimbursed from funds in the Residual Receipts Account.

**F. Withdrawals from the Residual Receipts Account.**

**The Lender must submit the following:**

1. Required Documents. A checklist of required exhibits to submit to HUD for withdrawals from the Residual Receipts Account will be available on the Section 232 Program website.
2. Additional Considerations. The following issues will be considered by ORCF in processing a request to withdraw funds from the Residual Receipts Account:
  - a. Whether the expenses are qualified items to be paid from the account.
  - b. Bid Requirements, if applicable (See the requirements set forth in Section 3.2, H of this chapter).
  - c. If the submittal proposes remodeling, adding to, subtracting from, reconstructing, or demolishing a portion of the mortgaged project (as discussed further in Section 3.4.4 of this chapter), an environmental review as required by 24 CFR Part 50 will be conducted in accordance with Production, Chapter 7.

**G. Processing Format.** ORCF recommends that requests to withdraw funds from the Residual Receipts Account be submitted electronically in PDF format or as a MS Word File.

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## **3.2.4**

## **Non-Critical Repair Account**

**A. Applicability:** Non-Critical Repair Escrow (“NCRE”) Accounts are established during the underwriting of a project and funded at Closing. The funds in the NCRE Account are

intended to pay for repairs identified in the Escrow Agreement for Non-critical Repairs (the “NCRE Agreement”). Normally, the repairs must be completed within 12 months from the date of the NCRE Agreement. The specific requirements and conditions for the completion of the repairs are set forth in said agreement.

**B. Depositing, Holding and Investing:** Funds in the NCRE Account must also be deposited, held and invested in accordance with the requirements set forth in Section 3.2.2 of this chapter. However, since the funds are intended to be disbursed within a 12 month period, they must be deposited in an account that can be withdrawn or immediately accessed in the full amount. Depositing NCRE Account funds in a long-term investment account is not recommended.

**C. Withdrawals from the NCRE Account** (except in connection with a final or close-out request)

1. Required Documents and Approval Authority. The Lender/Servicer must collect, review, and submit the following documents to HUD for review, accompanied by a recommendation of approval to be included in the email or fax submission:
  - a. Request for Approval of Advance/Release of Escrow Funds (Form HUD-92464-ORCF)
  - b. Borrower’s Certification - Full or Partial Completion of Non-Critical Repairs (Form HUD-92117-ORCF)
  - c. Supporting documentation required by Borrower’s Certification - Full or Partial Completion of Non-Critical Repairs.
2. Review of Proposed Withdrawal. When determining whether to approve a proposed withdrawal, HUD shall review the documentation above to determine whether there is adequate documentation to evidence that the repairs/improvements (associated with the requested release) were completed.

**D. Request to Close-Out the NCRE Account.**

Required Documents. After all repairs have been completed, the Borrower may request that all funds remaining in the NCRE Account be released, including funds that have been withheld for repairs and latent defects, if applicable. The Borrower must submit the following documents to ORCF with a request to close-out the NCRE Account, along with a written statement of review of all documents, and recommendation for approval by the Lender:

1. Request for Approval of Advance/Release of Escrow Funds.
2. Borrower’s Certification - Full or Partial Completion of Non-Critical Repairs form and supporting documentation required by the form.
3. If provided in the NCRE Agreement, the Borrower must deposit with the Lender, an amount approved by said Lender to correct latent defects (the “Latent Defects Deposit”). A Latent Defects Deposit is required when the request to close the NCRE

Account is less than 12 months from the date that the applicable repairs were completed. If the net total (or 100%) of the amount escrowed for repairs in an NCRE Account is less than \$100,000, the Borrower may request a waiver of the requirement to make a Latent Defects Deposit. The request for a waiver shall be submitted with the request to close-out the NCRE Account, either in a cover letter or via electronic mail to ORCF.

4. Evidence of Clear Title.

**E. Special Issues.**

1. Any proposed revision to the scope of the required repairs/improvements or request for an extension of the time to complete the repairs/improvements must be approved by the AE (submitted via email by the Lender). The following documents are required:
  - a. A narrative in the email request detailing why an extension is requested; or the reason that some or all of the non-critical repairs were not completed, as applicable.
  - b. Repairs that will not be completed on time or at all must be set forth on the Request for Approval of Advance/Release of Escrow Funds form.
  - c. The certification must provide which repairs will not be completed on time or at all (Borrower's Certification - Full or Partial Completion of Non-Critical Repairs).
  - d. Copy of the original NCRE Agreement.
  - e. Certification from a licensed inspector, architect, engineer, or the PCNA inspector. The certification must provide that: not completing the non-critical repairs will have no serious negative impact on the condition of the project; and the project, as completed, is in compliance with local building and zoning codes, and/or state regulations.
2. After completion of all required repairs/improvements, any excess funds in the Escrow attributable to the Repair Estimate Amount that were funded from Loan proceeds may be used for the following purpose(s): (a) to pay for additional repairs approved by Lender and AE, (b) to reduce the outstanding Loan balance; or (c) to deposit in the R4R. ORCF may also require that certain repairs be completed when the specified repairs are deemed necessary for the proper operation of the facility, for resident care and/or if the repairs are needed to comply with local and state regulations.

**F. Processing Format.** ORCF recommends that requests to withdraw funds from or to close-out the NCRE Account be submitted electronically in PDF format or as a MS Word File.

**G. Optional Process for Delegated NCRE Administration to Lenders/Serviceirs.**

**1. Purpose and Background.**

This optional process applies only to residential care facility transactions originated under Sections 223(f) and 223(a)(7). A prerequisite for participation is HUD approval of revisions to the Servicing Lender's Quality Control Plan incorporating the requirements of this Handbook.

## **2. Lender Approval Process**

If a Servicing Lender is approved by Multifamily Housing in accordance with Notice H2013-14 for delegated NCRE administration, ORCF shall consider the Lender approved to perform delegated NCFE administration for the loan types referenced in the previous paragraph. If a Servicing Lender wishes to apply for approval solely to administer NCRE's on residential care facilities, the request must be submitted electronically to the ORCF Director of Asset Management. The request must include a revised Quality Control Plan addressing the following items:

- Procedures to ensure the work is completed within the Project Capital Needs Assessment (PCNA) scope of work, within budget, and on time.
- Procedures to ensure completion of the Supplemental Cost Certification.
- The identification of the staff assigned to oversee the escrow administration and a primary point of contact. The Lender staff approving draw requests must be an approved Construction Loan Administrator.

HUD will retain responsibility for release of non-critical repair escrow funds in all cases where there is an identity of interest between the Borrower, the Lender, or affiliates of either.

## **3. General Requirements.**

Should the Lender elect to take responsibility for this task (and receive HUD approval to do so), HUD will not charge an inspection fee on Section 232 pursuant to Section 223(f) transactions. Section 223(a)(7) transactions do not require an inspection fee. ORCF has not established a minimum or maximum repair/improvement amount on which this delegated process may be used.

This delegated authority allows the Servicing Lender to review and approve all interim draw requests with the exception of the close-out of the account. The close-out of the account is detailed in Section 3.2.4.D., above. Under this delegated authority, the request to close-out the account must include a report from the PCNA provider, who prepared the report at underwriting, indicating they have performed an inspection and all required repairs or improvements have been acceptably completed. No such inspection or report is required for interim draws – see below discussion for the details on Lender processing and approval of interim draws.

The AE assigned to the project will be the Lender's point of contact throughout this process.

## **4. Processing Instructions.**

- a. The Lender's Firm Commitment application must specify that the Lender will assume noncritical repair escrow administration on that particular transaction.

The fee to pay the PCNA provider for the inspection/report after the repairs/improvements are completed may be treated as an eligible mortgageable cost.

- b. The Firm Commitment will include a Special Condition acknowledging that the Lender has been approved to administer the NCRE.
- c. The Lender may review and approve of all interim draw requests provided the scope of repairs/improvements is the same as those outlined in the Firm Commitment. If the scope deviates from that outlined in the Firm Commitment, the Lender must obtain the AE's approval of the revised scope (per Section 3.2.4.E.1. of this chapter) prior to moving forward with the approval of further draws.
- d. Interim draw requests reviewed under this procedure shall follow the submittal documents and process outlined in Section 3.2.4.C above, with the exception that the Servicing Lender may approve the draw. Lender approval will be evidenced by signing on the Request for Approval Advance of Escrow Funds, including their Name, Title and Organization. After approving the draw, the Lender shall email the AE a copy of the signed Request for Approval of Advance/Release of Escrow Funds form(no further documentation on interim draws is required to be submitted to HUD).
- e. The request to close-out the account shall be submitted to the AE and shall follow the submittal documents as outlined in Section 3.2.4.D above; however, it shall also include the PCNA provider's report as discussed above. If there is a Latent Defects Deposit remaining after the close-out of the account, such Latent Defects Deposit may be reviewed and released by the Lender after the required seasoning period has passed. No further documentation from HUD on this is required.
- f. The Lender must advise the AE via email if it is expected the repairs/improvements will not be completed prior to the maximum time period set forth in the escrow agreement or if there are cost overruns that would jeopardize the ability to fund all required repairs/improvements with the amount of escrowed funds.

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### 3.2.5

### Sinking Fund

- A. **The Sinking Fund Agreement** is the controlling document for the Sinking Fund. The Sinking Fund Account must remain in compliance with the Sinking Fund Agreement. ORCF must be promptly notified by the Lender in the event of any breach of the Borrower of the Sinking Fund Agreement and the Lender must further agree to seek specific performance or other injunctive relief for any breach.
- B. **Requests for Withdrawal from the Sinking Fund Account.** Withdrawals from the Sinking Fund Account may only be made for the specific purposes stated in the Sinking Fund Account Agreement. The Borrower must submit the request to ORCF. A checklist will be available on the Section 232 Program website.



- C. **Requests to close a Sinking Fund Account prior to expiration.** Normally a request to close the account prior to expiration of the mortgage is submitted when the state Medicaid provider, where the project is located, no longer requires the maintenance of a Sinking Fund Account, and the project is in good physical and financial condition. Since a Sinking Fund Account is beneficial to the interests of the Borrower, Lender and the Secretary in the latter years of a mortgage, a state rule eliminating the Sinking Fund Account does not automatically modify or remove the requirement for FHA-insured projects. The Borrower must submit the request to ORCF. A checklist will be available on the Section 232 Program website.

### 3.2.6

## Debt Service Escrow and Long-Term Debt Service Reserve Accounts

- A. **Applicability.** In specific instances, ORCF may have a Long-Term Debt Service Reserve account established at closing (See Production, Chapter 2). This account is a mortgageable item and is controlled by terms of the Borrower Regulatory Agreement. This account is different from a Debt Service Escrow account, which is for a shorter term, is funded by the Borrower, and is governed by a separate escrow agreement. The Long-Term Debt Service Reserve Escrow Account, if required, is established during the underwriting of a project either at initial or final closing. Each of these accounts is intended to provide Borrowers with an extra "cushion" to meet debt service payments on the FHA mortgage and thus, safeguard the project's financial viability. Funds in these accounts are to be used exclusively for payments of principal and interest on the Mortgage Note, or to meet project escrows such as insurance premiums, real estate taxes or special assessments.
- B. **Holding and Investing Funds.** Generally, the requirements of Debt Service Escrow Account are set forth in the Escrow Agreement, and the requirements of the Long-Term Debt Service Reserve Account are set forth in the Borrower Regulatory Agreement. The funds in these accounts are to be invested and safeguarded by Lenders and Borrowers in the manner described in Section 3.2.2 of this Handbook. The procedures and sanctions described in Section 3.2.2 also pertain to these accounts.
- C. **Request for Withdrawal:** The following documents are to be submitted when requesting funds from a Mortgage Reserve/Debt Service Reserve Account.

#### Required Documents:

- Request for Approval of Advance of Escrow Funds. Note: On top left side of Page 1, Draw a line through "Advance Escrow Funds" (Strikethrough) and write in "Mortgage Reserve/Debt Service Reserve Account."
- Copy of Escrow Agreement and Schedule, if applicable.
- Copy of the mortgage statement, invoice, or a list of monthly mortgage payments to be paid by this request.
- Cash flow for month funds will be applied to mortgage payment
- Current financials for previous 12 months, by month.

- Bed/unit census for the previous 12 months, by month.
- Forecast bed/unit census for the next 12 months, by month.
- Budget for the next 12 months, by month
- Most recent State Survey/Inspection

**SPECIAL NOTE:** Any request deviating from the Mortgage Reserve/Debt Service Reserve Agreement, or any amendments and schedules thereto, shall be closely analyzed by ORCF. The approval will be conditioned with a full repayment of the funds to the account within a reasonable time frame.

**D. Additional Considerations.** The following issues will be considered by ORCF in processing Mortgage Reserve/Debt Service Reserve Account.

1. Financial and Physical Condition of the Project.
2. Open ORCF and State compliance Issues.
3. Other relevant issues, information or documents as determined by ORCF.

**E. Processing Format:** ORCF recommends an electronic submission via email as PDF or MS Word File.

### 3.2.7

## Initial Operating Deficit Escrow

**Applicability.** Initial Operating Deficit (IOD) Escrow Accounts are restricted accounts that are primarily designed to allow or assist the project to achieve sustained occupancy and adequate revenue. Disbursements from the IOD Escrow Account may be authorized monthly by ORCF to meet any cash deficit in the operation of a project for the period immediately following substantial completion of construction.

**SPECIAL NOTE:** The IOD Escrow Account is a part of the Project's necessary start-up working capital. ORCF does not consider depreciation, officers' salaries, and identity of interest management fees to be reasonable operating expenses; therefore, funds in the IOD Escrow Account may not be used cover those costs.



## Section 3.3

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# Prepayment Provisions and Prohibitions

### 3.3.1

### Introduction

**Applicability.** The Residential Care Facilities Program permits Lenders to insert prepayment lockouts and penalties into the FHA-insured Note for the benefit of the source of the financing in accordance with the guidelines set out in Production, Chapter 3. Prepayment request review procedures are as follows.

### 3.3.2

### Prepayment Procedures

HUD must receive notification in writing from the Lender, requesting to prepay a loan insured by FHA (or voluntarily terminate its mortgage insurance). The following are the steps for processing a request for prepayment of an FHA-insured mortgage or a voluntary termination of mortgage insurance:

- A. Lender submits the Insurance Termination Request for Multifamily Mortgage form (Form HUD-9807) (without Block 5 completed) to the Multifamily Insurance Operations Branch in HUD Headquarters. That Office forwards a copy of the form and supporting documentation to the ORCF, which will verify that there are no prepayment restrictions for the particular project. In most cases, HUD Counsel review will not be required, but ORCF will coordinate as necessary.
- B. The following must accompany the Insurance Termination Request for Multifamily Mortgage request from the Lender:
  - Mortgage, Mortgage Note, Deed of Trust, Deed of Trust Note, Riders, any Allonges or Amendments, Regulatory Agreement, Trust Indenture (if the Project is bond financed), any secondary financing and status, use restrictions and any special requests from the Lender or Borrower.

Review of the prepayment request by HUD cannot begin without the above information, along with the executed Insurance Termination Request for Multifamily Mortgage form. The complete submission of the documents is the responsibility of the Lender.

- C. ORCF will ensure the following:

1. Determine if prepayment falls within any lockout period;

2. Determine status of any secondary financing and review the HUD asset management system (iREMS);
  3. Determine any outstanding Departmental Enforcement Center (DEC) or Office of Inspector General (OIG) investigations, based on iREMS; if any exist, obtain input from the appropriate Division on prepayment approval.
  4. Address any special requests the Lender may have prior to closing. Termination of the Borrower Regulatory Agreement would be deemed a special request, and would need to be prepared by HUD's Office of General Counsel.
- D. The Office of Multifamily Insured Operation Branch will perform an audit of the loan(s) to calculate the estimation of payoff (based on projected closing date) and any refund due to the Project for overpayment of MIP, if applicable.
- E. The Lender must ensure the Office of Multifamily Insured Operation Branch is notified of the closing date that is scheduled by the Project's counsel (and bond issuer, if applicable).
- F. For closing and bond defeasance, the bond issuer defeases the bonds and sends HUD the complete Form 9807. Prior to closing the Lender must coordinate with the Multifamily Insured Operation Branch Chief to ensure timely processing of the Form 9807.
- G. ORCF will reflect the prepayment once the Office of Multifamily Insured Operation Branch has confirmed that the payoff occurred. The ORCF must update iREMS to ensure the Project no longer is required to submit financial statements (if fully terminated from FHA-insurance) and document that the prepayment has occurred. Special care must be taken to ensure the Project is fully terminated from FHA-insurance prior to making updates to iREMS. For example, a refinance under Section 223(a)(7) involves a payoff of the existing loan, but the refinanced loan is still required to submit financial statements.

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### **3.3.3**

### **Prepayment Lock Outs and Penalties**

- A. Language allowing HUD to override the prepayment lockout and/or penalty provisions in the event of a default is included in the Healthcare Facility Note (Form HUD-94001 ORCF).
- B. Where these restrictions exist, and the Lender does not waive its optional prepayment or lockout penalty provisions, in rare circumstance HUD would consider exercising an override of a Lender's prepayment lock-out or penalty provision in order to avoid a full claim. Any override to the lockout must receive approval by the Deputy Assistant Secretary for ORCF. Generally speaking, these projects will be in, or transferred to, the ORCF Risk Mitigation Branch portfolio due to the troubled nature of the project. As part of the workout necessary to avoid a claim, a background memo is prepared from the Risk Mitigation AE, explaining the

circumstances justifying the request. Consideration must be given to all of the following, in providing such justification:

1. The Borrower has defaulted and HUD has received notice of such default as required by the regulations.
  2. HUD determines that the project has been experiencing a net income deficiency that was not caused solely by management inadequacy or lack of Borrower interest and that is of such a magnitude that the Borrower is currently unable to make required debt service payments, pay all project operating expenses, and fund all required reserves.
  3. HUD finds there is a reasonable likelihood that the Borrower can arrange to refinance the defaulted loan at a lower interest rate or otherwise reduce the debt service payments through partial prepayment.
  4. HUD determines that refinancing the defaulted loan at a lower rate or partial prepayment is necessary to restore the project to a financially sound condition and to avoid an insurance claim.
- C. If a Borrower desires HUD's override of the lockout, it must initiate the written request to ORCF.
- D. ORFC must be satisfied that the Borrower in these circumstances did not intentionally cause a default in order to obviate prepayment penalties or lockout provisions.

## Section 3.4

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# Request to Release or Modify Original Loan Collateral

### 3.4.1

#### Introduction

From time to time the collateral securing a FHA-insured mortgage needs to be modified or released. The Regulatory Agreement provides language requiring prior HUD approval of a revision to the security or collateral, including the following:

- A. Reduction, Addition, or Sale of Beds (Please refer to 3.4.2 below)
- B. Easements, Eminent Domain, or Sale of Land or Other Security (Please refer to 3.4.3 below)
- C. Remodeling, Adding to, Subtracting From, Reconstructing, or Demolishing Portions of the Mortgaged Project (Please refer to 3.4.4 below)

A checklist of required exhibits to submit to HUD in each situation will be available on the Section 232 Program website.

### 3.4.2

#### Reduction, Addition, or Sale of Beds

- A. **Applicability:** Licensed beds are valuable project assets securing the mortgage. Any time the number of licensed beds in the project are being reduced or increased, the value of the mortgaged project may be affected.
- B. **Additional Considerations:** The following issues will be considered by ORCF in processing a Reduction or Increase of number of beds:
  - 1. Financial and Physical Condition of the Project.
  - 2. Open HUD and State Compliance Issues.
  - 3. Project's PCNA (Physical Condition and Needs Assessment). If PCNA is more than 10 years old, ORCF may require a new PCNA to be performed.
  - 4. The value of the remaining project after approval will be unaffected or the value will still be sufficient to cover the remaining balance of the mortgage.
  - 5. Other relevant issues, information or documents as determined by ORCF.

6. ORCF will engage the services of HUD OGC (and as needed, OHP Architecture & Engineering, and/or Appraisal teams) to review all legal and technical issues.
  7. In processing release of collateral requests in which funds are being received for the sale of beds, ORCF will expect to receive market value for the released collateral and the funds will be directly applied to the mortgage balance. Any deviation from this must be expressly approved by ORCF.
- C. **Processing Time.** The concurrent reviews by HUD OGC and OHP Architecture & Engineering, if required, will affect the length of processing time.
- D. **Other ORCF Requirements.** It should be noted that in all increase or reduction of licensed bed requests, ORCF may require or request additional relevant documents or information.

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### 3.4.3

### Easement, Eminent Domain, or Sale of Land or Other Security

- A. **Applicability.** The Regulatory Agreement provides that the Borrower shall not, without the prior written approval of HUD, convey, transfer, or encumber any of the mortgaged project. Generally, there are two types of partial release of security requests. Negotiated release is when the transaction is voluntarily negotiated between the parties. Involuntary or eminent domain action is when a local or State agency exercises its function to use a project asset for public use. In both situations, the project must be compensated for the asset appropriated or affected (Please see Section 232 Program website).
- B. **Negotiated or Voluntary Partial Release of Security.** This can include the sale of a portion of project land, part of a building, major assets, etc. Note: Although Easements and Right of Ways are not technically a release of security, the approval requirement in this subchapter will be applicable. Normally, ORCF will consider approving such requests when:
1. The quiet enjoyment of the present tenancy will not be negatively affected.
  2. The amount of the reimbursement (or sale) is greater than or equal to the ORCF-determined value of the severed portion at the time of severance.
  3. The value of the project will be unaffected by the partial release of security or the value will increase as a result of it.
  4. The terms of the sale are cash.
  5. The security to be released is not in place to mitigate an environmental condition on the site.
- C. **Additional Considerations.** The following issues will be considered by ORCF in processing a Partial Release of Security request:

1. Financial and Physical Conditions of the Project.
2. Open HUD and State compliance Issues.
3. Project's PCNA (Physical Condition and Needs Assessment). If PCNA is more than 10 years old, ORCF may require a new PCNA to be performed.
4. The value of the remaining project after approval will be unaffected by the partial release of security or the value will still be sufficient to cover the remaining balance of the mortgage.
5. Other relevant issues, information or documents as determined by ORCF.
6. ORCF may also engage the services of the HUD OGC, the OHP Architecture & Engineering, and/or Appraisal teams to review all legal and technical issues.
7. If Ginnie Mae securities are involved, the Lender must ensure compliance with Ginnie Mae.
8. In processing Partial Release of Security requests in which funds are being received, ORCF will expect to receive market value for the released collateral and the funds will be directly applied to the mortgage balance. Any deviation from this must be expressly approved by ORCF.

D. **Processing Time.** The concurrent reviews by HUD OGC and OHP Architecture and Engineering, if required, will affect the length of processing time.

E. **Involuntary or Eminent Domain Partial Release of Security.** As soon as an involuntary partial release is known, the Borrower, Operator, Management Agent and/or Lender shall immediately notify ORCF. A copy of all received notices, documents, plans, proposals, or documents related to the proceeding, shall immediately be given or forwarded to ORCF. Urgency is required, because when a portion of the mortgaged project is taken by a public authority through the use of condemnation proceedings, such taking can be without the prior approval of either the Lender or ORCF.

If ORCF's field review indicates that the proposed condemnation has the potential to cause default of the mortgage or negatively impact on the quiet enjoyment of the intended purpose, as early as possible in the process, ORCF field staff must consult with the Director, Asset Management and Lender Relations immediately.

### 3.4.4

## Remodeling, Adding to, Subtracting From, Reconstructing, or Demolishing Portions of the Mortgaged Project

- A. **Applicability.** The various forms of Borrower and/or Operator Regulatory Agreements existing on residential care facility projects require written approval from HUD prior to remodeling, adding to, subtracting from, reconstructing, or demolishing a portion of the mortgaged project. “Remodeling” for purposes of this Section is defined as repairs/improvements that constitute “Substantial Rehabilitation” – as defined in the Production, Chapter 2.6.B. This chapter provides instructions on submitting a request for partial release of security from the insured mortgage. (See Section 3.4.3 of this chapter - Easement, Eminent Domain, or Sale of Land or Other Security).
- B. **Prior Approval.** It is important that no major capital additions or reductions are performed without prior ORCF consent. However, in some instances when the additions or reductions were already completed without prior ORCF approval, a retroactive approval may be available. The same documents required in this section must be submitted. It should be noted although a retroactive approval is being processed, ORCF reserves the right to enforce its regulatory authority.
- C. **Additional Considerations.** The following issues will be considered by ORCF in processing a request for Major Capital Additions or Reductions of the mortgage security:
1. Financial and Physical Condition of the Project.
  2. Open ORCF and State Compliance Issues.
  3. Project’s PCNA (Physical Condition and Needs Assessment). If PCNA is more than 10 years old, ORCF may require a new PCNA to be performed.
  4. The value of the remaining project after approval will be unaffected by the Major Capital Addition or Reduction, or the value will still be sufficient to cover the remaining balance of the insured mortgage.
  5. Other relevant issues, information or documents as determined by ORCF.
  6. ORCF may also engage the services of the HUD OGC and OHP Architecture and Engineering and/or Appraisal teams to review all legal and technical issues.
  7. An environmental review as required by 24 CFR Part 50 will be conducted in accordance with Production, Chapter 7 on any proposal for remodeling, adding to, subtracting from, reconstructing, or demolishing a portion of the mortgaged project.
- D. **Processing Time.** The concurrent reviews by HUD OGC and OHP Architecture and Engineering if required, will affect the length of processing time.

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**3.4.5****Surplus Cash Note Request**

Upon receipt of a request for a Surplus Cash Note from the Borrower, the Servicer will review the request, determine cause for the Note, and provide any necessary supporting information to the AE, along with a recommendation for approval, modification or rejection. The supporting information must include, but is not limited to: amount of request, purpose, terms and source.

The AE and Servicer will collaborate prior to HUD making a final determination.



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## Section 3.5

### Nursing Home Surveys and Licensure

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#### 3.5.1

#### Introduction

The ORCF insures mortgages for skilled nursing facilities. This type of project is licensed, highly regulated, and routinely monitored by the State in which the project is located. Maintaining ongoing compliance with the State is critical in ensuring the quality of care provided to the residents and the success of the project over the life of the mortgage.

ORCF does not intend to intervene between the State and another Federal agency. ORCF monitors the FHA-insured portfolio and when it is clear that the project is not able to come into compliance, the project will be turned over to the Risk Mitigation Branch for special servicing and work-out efforts. Since the license is collateral for the FHA-insured mortgage, it is critical that the license remains intact and the residents of FHA-insured projects receive safe, sanitary, and decent housing.

As such, HUD provides State survey information to ORCF staff and FHA-insured Lenders that service the ORCF portfolio. This web-based dashboard captures health inspection reports for every FHA-insured skilled nursing facility, flags Special Focus Facilities or watch list designations, and provides other operational data relevant to the successful operations of the project. The portal has the functionality to critically analyze a specific project along with providing national benchmark data.

HUD is providing this portal to Lenders for incorporation in their servicing and underwriting model for all projects that are currently FHA-insured. If a Lender would like access to the site for their portfolio, they may email [surveyresults@hud.gov](mailto:surveyresults@hud.gov).

Each Servicer must have a unique login and password to the survey performance database, and must periodically monitor their entire FHA-insured residential care facility portfolio.

This chapter will provide an overview of the inspection process and other tools the Center for Medicare and Medicaid Services (CMS) uses to rate and rank projects in order to help consumers, their families, and caregivers compare nursing homes in a specific area.

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#### 3.5.2

#### State Licensing and Surveys Overview

CMS contracts with each State to provide nursing home surveys that ensure that minimum Medicare and Medicaid quality and performance standards are being met. CMS, a part of the

Federal government, certifies projects to receive payments from Medicare and Medicaid. Once certified the project is then a nursing home provider for Medicare and Medicaid services. Each State government oversees the licensure process for each project with that State. There are over 150 regulatory standards that nursing homes must meet at all times in order to ensure quality and performance standards. Meeting these minimum standards allows a project to receive Medicare and Medicaid payments and remain licensed with each State. If the regulatory standards are not being met, as shown through the survey process, then CMS can impose penalties, remedies or sanctions and possibly revoke all Medicare & Medicaid funding.

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### **3.5.3**

### **State Inspection Process**

Nursing Home State Surveys and Health Inspection are two terms that describes the nursing home State Inspection process and the terms are often used conterminously, in conjunction and/or separately from each other (e.g., State Survey, Health Inspection Survey, State Health Inspection, State Inspection, etc.). States contract with CMS to monitor nursing homes that provide care to individuals that receive Medicare and Medicaid. Health Inspections of nursing homes are conducted routinely, about every 9-15 months, by the State survey team. The State will perform more frequent survey inspections if there are complaints or the project is poorly performing. During the nursing home inspection process the State reviews many aspects of quality and performance standards. The survey is comprised of an inspection team that is normally made up of trained inspectors which include but are not limited to a registered nurse, a licensed or certified social worker and a certified life safety code inspector. Surveys are performed unannounced to the project and can be performed 24 hours a day and can fall on any of the 365 calendar days. A survey generally lasts 3-5 days which can include non-business hours and/or weekends. The survey team routinely ensures residents are safe and free from immediate jeopardy. If severe deficiencies are found which has risen to the level of harm or immediate jeopardy then the survey may be extended. The survey team follows the survey process and evaluates whether the project is meeting individual resident needs and providing quality of care as defined by CMS. The survey covers various aspects of a resident's stay within a nursing home such as resident life, quality of care, safe and sanitary food preparation processes, staff/resident interactions, environment, policy and procedures and, among numerous others, abuse and neglect.

When an inspection team finds that a project does not meet a regulatory standard they issue a deficiency/citation. The State routinely allows 45 days from the date of the survey to correct deficiencies. The State also requires the project to provide a statement of correction to prevent the deficiency from occurring in the future. The State may follow up at the project by conducting another unannounced visit to the project or completing a desk review. If the deficiency is not corrected then the State recommends appropriate enforcement actions to the State Medicaid agency for Medicaid and to the regional office for Medicare. The CMS regional office determines a project's eligibility to participate in the Medicare program based on the State's survey results and the project's compliance. If the regulatory standards are not being corrected then CMS can, depending on the severity of the violation, take action against the nursing home including imposing various remedies and possibly revoking all Medicare and Medicaid funding.

Nursing home surveys are posted on the Medicare.gov website.

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### **3.5.4**

## **State Inspection Process (Life Safety)**

To be eligible to be a Medicare & Medicaid Nursing Home Provider the project must be in compliance with the 2000 edition of Life Safety Code (LSC). Projects that have waivers of the health occupancy provisions of the LSC or an acceptable Plan of Correction (POC) are also considered in compliance. The LSC is a set of fire protection requirements that provides a reasonable degree of safety from fire.

The LSC only uses qualified fire safety inspectors to perform the Life Safety Survey. The nursing home must also meet the minimum Life Safety Code at all times and will receive deficiencies for non-compliance of the Life Safety Code. The LSC inspectors will make reports and recommendations to the State agency. The State routinely allows time to correct a deficiency. If the regulatory standards are not being corrected then CMS can, depending on the severity of the violation, take action against the nursing home including imposing various remedies and possibly revoke all Medicare & Medicaid funding.

The Life Safety Surveys are located on the Medicare.gov website.

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### **3.5.5**

## **Quality of Care Provided to the Residents**

The survey process each project undergoes is an effort of CMS to oversee that quality of care is being given to each resident. CMS has established Quality Measures that are used during the survey. These Quality Measures are measurable, valid, reliable and are submitted to CMS on a routine basis. The nursing home quality measures come from actual residents that stay within each project. This data is routinely collected and measures the resident's physical and clinical conditions and abilities, as well as preference and life care wishes. This data is further converted to allow consumers to another source of information that shows how well nursing homes are caring for their resident's physical and clinical needs. This data can be viewed on the Medicare.gov website.

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### **3.5.6**

## **Star Rating**

CMS created a Five-Star Quality Rating System. This system is intended to assist family members, consumers and care givers to compare nursing homes more easily and help identify questions that they may wish to ask. The Five-Star Quality Rating System is located on the Nursing Home Compare website. The website has a quality rating system that gives each of the 4 categories between 1 and 5 stars. Nursing homes with 5 stars are considered to have "much above average" quality and a nursing home with a 1 star rating is considered to have quality

“much below average”. The four categories of the Star Rating are Overall, Health Inspections, Staffing, and Quality Measures. The actual star rating is based on technical guidelines to establish each star rating.

**Overall Star Rating:** Takes into account the other three categories (Health Inspections, Staffing and Quality Measures) and then gives an Overall Star Rating for the project.

**Health Inspection:** The health inspection rating contains information from the last 3 years of onsite inspections, including both standard surveys and any complaint surveys. The most recent survey findings are weighted more than the prior two years based on the technical guidelines.

**Staffing:** The staffing rating has information about the number of hours of care on average provided to each resident each day by nursing staff. This rating considers differences in the level of need of care of residents in different nursing homes.

**Quality Measures:** The quality measure rating has information on 10 different physical and clinical measures for nursing home residents. This information is collected by the nursing home for all residents. The Quality Measures offers information about how well nursing homes are caring for their residents' physical and clinical needs.

The Star Rating can be viewed on the [NursingHomeCompare.gov](https://www.nursinghomecompare.gov) website.

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## 3.5.7

## Special Focus Designation

CMS has a Special Focus Facility Initiative that places a nursing home, with a history of serious quality issues, into a special program that is meant to stimulate the project to improve their quality of care to residents. Most of the projects placed on the Special Focus Facility Initiative Program have previously shown the following within the past three year survey history:

- A. Surveys have twice the amount of deficiencies as other nursing homes.
- B. More serious survey deficiencies than most other nursing homes. These deficiencies would include Harm and Injury experienced by the residents.
- C. A pattern of problems that persisted over the past 3 years of surveys.

These projects are visited twice as often as regular projects (twice per year). Enforcement action becomes more stringent as more problems continue. There are three options after the project has been in the program and within the 18-24 month timeframe:

1. **Improvement and Graduation:** The project advances to an Improved Status and eventually Graduates from the program. This project would resume annual surveys and continue being a Medicare and Medicaid Provider.

2. **Termination:** This project has not met the criteria to graduate from the Special Facility Program, is not making progress and is terminated from providing services to Medicare and Medicaid recipients.
3. **Extension of Time:** An extension of time can be given to a project that is showing improved progress but not enough progress to advance to Improving/Graduated status. An extension of time could also be granted if there is a sale of the project.

Special Focus Designation can be found on the [www.CMS.gov](http://www.CMS.gov), [www.NursingHomeCompare.gov](http://www.NursingHomeCompare.gov) and <http://www.medicare.gov/> website.

All Special Focus Facilities will be serviced by the Risk Mitigation Branch.

## **Section 3.6**

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# **Approval to Participate in HUD Programs - APPS and BPRS**

### **3.6.1**

#### **Introduction**

- A. The Office of Healthcare Programs' Section 232 Program requires the principals in a proposed transaction to submit certain types of forms containing information. This information is requested in order to demonstrate to HUD, their experience and the team of people who are planning to own, operate or manage a project with a Section 232 FHA-insured mortgage. Application submission requirements are contained in the application exhibits for new endorsement in accordance with the appropriate Section of the Act, including but not limited to, resumes, credit reports, and project licenses. In addition to proposed applications for a FHA-insured mortgage, a proposed change of Borrower (Transfer of Physical Assets), Change of Operator, or Change of Management Agent require approval by ORCF. These requirements can be found in Asset Management, Chapter 7 and Chapter 8.
- B. Regardless of the proposed transaction or event that triggers participant approval – i.e. newly proposed FHA mortgage insurance requests or change of entity--approval as a Section 232 Program participant by ORCF is a HUD requirement. ORCF uses the Active Partners Performance System (APPS) and Business Partners Registration System (BPRS) to ensure proper clearance and up-to-date information on participants doing business with HUD. This chapter provides an overview of the general steps necessary for participants in ORCF programs to receive approval via APPS and to register in BPRS.

### **3.6.2**

#### **Participation Requirements**

- A. As stated above, principals in the proposed transaction(s) must submit information regarding their previous participation in governmental housing transactions, further outlined below in Section 3.6.3. Clearance via APPS is generated upon the submission of the Previous Participation Certification (Form HUD-2530) for approval for participation in any FHA-insured mortgage program. HUD encourages filing the Previous Participation Certification electronically. However, ORCF also accepts paper copies of the Previous Participation Certification for processing. The participant will be notified upon approval for participation based on APPS clearance. It should be noted that clearance of a participant via APPS does not necessarily mean that there are no further concerns (i.e. concerns with capacity or experience) with that entity. Approval via APPS simply confirms that there are no outstanding violations based on past experience with housing programs that have been determined from the APPS database. Therefore, APPS approval is just one step in the participant approval process. Participants should work with the ORCF staff processing the

transaction to ensure their approval for the particular transaction under review. The Previous Participation Certification submissions must be approved prior to issuance of a Firm Commitment or approval of a TPA or change of operator or Management Agent. Should participants change or revise the participants during a submission, the previous participation submittals must be revised and reapproved prior to closing or change of entity.

- B. HUD issued an APPS Users' Guide for the Industry (the Guide), found at: [http://portal.hud.gov/hudportal/HUD?src=/program\\_offices/housing/mfh/apps/appsindustryug](http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/mfh/apps/appsindustryug). The Guide serves to provide specific details in registering and in using the electronic system. All ORCF Mortgagees and Borrowers who have been designated as APPS input contacts with secure access should become familiar with the Guide.
- C. The Guide further details the four types of Previous Participation Certification submissions: Baseline, Project, Organization Change and Identity Change. Project submissions include New Application for Mortgage Insurance, Refinance Application for Mortgage Insurance; New Role for Project, Transfer of Physical Assets. Organization Change Submissions and Identity Change also require ORCF review.
- D. In addition to APPS, HUD designed BPRS, which is separate from the APPS Previous Participation Certification submission and approval process. Accurate, up-to-date data on participants (including names and addresses) is critical to smooth submissions in the REAC Financial Assessment Sub-System (FASS) which uses information from this system. This data is also used in HUD's integrated Real Estate Management System (iREMS) used by the AE.

Registering as a business partner and applying for a coordinator ID and Password is a four step process which is required to be done in this specific sequence:

1. First, a user needs to register in the Business Partner Registration system: [http://hudapps.hud.gov/appspart\\_reg/apps040.cfm](http://hudapps.hud.gov/appspart_reg/apps040.cfm).
2. Second, after registration on the Business Partner Registration System, it is necessary to wait a 24 hours for the registration to take effect.
3. Third, apply as a Coordinator or User for Secure Systems on the Secure Systems Registration page.

If you are a Coordinator for a participant (entities/people), you can change all information except the TIN, Legal Structure and Ownership Type by accessing Edit Participant Detail from the Participant Processing drop down menu on APPS home page.

4. Fourth, after the business partner registration has been completed, the user needs to go to: [http://hudapps.hud.gov/public/wass/public/participant/partreg\\_page.jsp](http://hudapps.hud.gov/public/wass/public/participant/partreg_page.jsp) where a Coordinator/User can choose their password and indicate it on the Secure Systems Registration Page.



Once this has been completed, a Coordinator or User ID is mailed out within two (2) weeks to the Borrower/CEO.

Access key codes are mailed to the address in APPS. While requesting access codes, make sure the address you are confirming is the correct address. If not, correct the address before requesting access code. For corrections, contact your AE with documents showing correct information.

### **3.6.3**

## **Principals Required to File Previous Participation Certifications**

A. For any new project submission transaction, the following project participants are principals and must file either an electronic Previous Participation Certification APPS submission or a paper Previous Participation Certification:

1. Borrower
2. Management Agent
3. Operator
4. Master Tenant
5. General Contractor

B. For each principal that is one of the types of entities listed below, the following additional entities or individuals are also principals for APPS and Previous Participation Certification purposes:

1. Limited Liability Companies
  - a. All Managing Members regardless of their ownership percentage
  - b. All Members with 25% or more ownership in the Limited Liability Company
2. Limited Partnerships
  - a. All General Partners regardless of their ownership percentage
  - b. Limited Partners with 25% or more ownership

EXCEPT: Limited Liability Corporate Investors (LLCIs) may file a LLCI certification instead of the Previous Participation Certification (HUD-2530) form.

3. Corporations
  - a. All Corporate Officers (President, Vice-President, Secretary, Treasurer, etc. This includes non-profit officers of the board of directors and staff members who are considered corporate officers)
  - b. All members of the Board of Directors (this includes all non-profit board members)
  - c. For publicly traded companies, all stockholders that own 10% or more of the company's stock



- C. Other previous participation with HUD must be shown. Submittals via paper or electronic must contain details concerning other FHA-insured or funded projects in which the applicant has participated.
- D. HUD now accepts duly signed PDF signature packages in lieu of wet signatures for electronic Previous Participation Certification submissions. Applicants may upload the duly signed PDF packages instead of mailing the same. After uploading the PDF for Organization changes, please send an email to your AE with a request for notification of Previous Participation Certification submission package approval.
- E. Previous Participation Certification signature authorization document exemptions:
  - 1. If the president or CEO of a corporation signs for the entity, no other signature authority document is required.
  - 2. If the managing member of an LLC is a person and signs on behalf of the entity, no other signature authority document is required.
  - 3. If the GP of a partnership is a person and signs on behalf of the entity, no signature authority document is required.

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### **3.6.4**

### **Information Gathered**

- A. For both electronic APPS submittals and paper Previous Participation Certification submissions, HUD will check the following data sources for derogatory information, shown as critical findings or flags, on the entities being reviewed:
  - 1. Government-wide Suspensions and Debarments that APPS downloads from the GSA Excluded Parties List System (EPLS).
  - 2. Participant Flags that HUD staff entered into APPS.
  - 3. PPRS/F19 Participant Flags that HUD staff originally entered into that system and which have been converted into APPS.
- B. ORCF will further research any findings or flags and inform the Mortgagee or Borrower of the issues needing resolution. ORCF uses established procedures in placing or resolving a flag, including notifying a participant of the flagging, potentially impacting a participant's ability to do future business with HUD. The Processing Steps for an electronic submission (Previous Participation Certification) is found in Appendix 1 of this chapter.
- C. Examples of Flag Reasons maintained in APPS include:
  - Indictment or Other Formal Charge of Criminal Activity

- Debarment
- Deed in Lieu
- Mortgage Default
- Default – Surety Performance, Fidelity Bond
- False or Incomplete Previous Participation Certification
- Foreclosure
- Limited Denial of Participation
- Mortgage Assignment
- Mortgagee-In-Possession
- Suspension
- Suspension/Termination of Payment
- Unresolved Audit Findings
- Violation Regulatory Agreement

D. While some flags can be resolved by the AE, flags that cannot be resolved and therefore remain for historical purposes include the following:

- Debarment
- Deed in Lieu
- Foreclosure
- Mortgage Assignment
- Mortgagee-In-Possession
- Suspension

Accordingly, ORCF encourages all participants to check this information in the electronic system for accuracy and provide timely and responsive explanations when trying to do new business with HUD.

### **3.6.5**

### **Procedure for Participants with Flags**

- A. If the submittal contains any of the above issues that appear as flags in APPS, these issues must be addressed in the application for new business before approval of the transaction can occur. Therefore, no Firm Commitments will be conditioned on APPS approval, or only with special rare exception as discussed and approved by Loan Committee. This explanation is also required for new entities involved with a Section 223(a)(7) refinance and/or Transfer of Physical Assets approvals.
- B. If the participant is found to have derogatory information in the APPS system, the ORCF Staff assigned to the project is required to address the specific issues via the loan committee memo or memo to the file for other asset management actions such as a Transfer of Physical Assets.

- C. If the submittal contains derogatory information on the participant and these items cannot be resolved, the submittal will have to be submitted by the ORCF Underwriter or AE to the Workload Manager via a memo for approval.

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## Section 3.7

### Physical Condition

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#### 3.7.1

#### Introduction

The physical condition of every ORCF Section 232 FHA-insured facility is a critical factor in managing the overall risk to the FHA mortgage insurance fund to ensure the residents are residing in safe housing. ORCF strives to provide and promote the effective use of timely and reliable information to monitor and assess the condition of the ORCF Section 232 portfolio. Such assessment tools also provide valuable information to help ensure safe, decent and affordable housing is maintained throughout the ORCF Section 232 portfolio.

#### 3.7.2

#### Physical Condition Monitoring Tools

##### A. Real Estate Assessment Center (REAC) Physical Inspections.

1. **General Background.** On September 1, 1998 (63 FR 35650), HUD published a final rule that established uniform physical condition stands for housing insured and or assisted under certain HUD programs. These standards are intended to ensure that this housing is decent, safe, sanitary and in good repair. The September 1, 1998 final rule also established uniform physical inspection procedures by which HUD determines compliance with the physical condition standards.
2. **REAC and ORCF Section 232 Projects.** HUD's Real Estate Assessment Center (REAC) is charged with responsibility for assessing and scoring the condition of certain projects in which HUD has an interest, including FHA-insured projects under the Section 232 Program, in accordance with the physical conditions standards and procedures of 24 CFR part 5 subpart G.
  - a. **ORCF 232 Projects.** ORCF will continue to use the Real Estate Assessment Center (REAC) to schedule and physically inspect all projects in the ORCF Section 232 portfolio unless stated otherwise below.
  - b. **Skilled Nursing Facilities.** This provision (24 CFR 200.855) is now applicable and it limits the inspections on skilled nursing facilities. It provides in part that REAC will no longer routinely perform physical inspections on skilled nursing facilities (though HUD can direct on a case-by-case basis that one be conducted). In applying this provision, HUD has halted the inspections on projects categorized in HUD's database as SNFs. This can include skilled nursing facilities that do have some non-skilled nursing units, but are predominantly providing skilled nursing care.

- c. **Other Non-SNF Exceptions.** The provision also gives HUD the authority to determine that other (non-SNF) projects in a particular jurisdiction do not need REAC inspections if HUD finds that a particular jurisdiction provides adequate inspections with readily available results. Action, if any, with respect to that authority will be announced at a later date.
- 3. **Administration of REAC Inspections.** REAC inspects only a random sampling of the project to determine if the project is properly maintained. REAC conducts physical inspections through the use of contracted inspectors trained by REAC. The inspectors schedule on-site inspections with project Borrower's representatives. For assistance, questions, clarification, guidance and or questions, on procedures pertaining to REAC physical inspections, including scoring procedures and procedures and timelines to appeal an inspection report, refer to REAC's website ([see Appendix 3.2](#)).
- 4. **Exigent Health and Safety Items.** At the conclusion of a REAC Inspection, the inspector provides the Borrower, or designated contact, a list of all Exigent Health and Safety (EH&S) items. Once an inspection is conducted, the Borrower is responsible for mitigating all identified EH&S items within 72 hours, as verified by submission of the completed and signed certification to the assigned AE.
- 5. **Issuance of REAC Inspection Report.** REAC is responsible for verifying inspection data provided from the contracted inspector based on the on-site inspection. REAC scores and issues the formal REAC inspection report to the Borrower's contact, as verified at the on-site inspection.
- 6. **ORCF Actions and Referrals to the DEC in Response to REAC Inspection Report.** If the REAC inspection report score falls under 60 (on a scale of a possible 100 points) twice, the AE will refer a Borrower to the Departmental Enforcement Center (DEC) for further review and possible enforcement action. Before referring to the Enforcement Center, the AE will review both inspections and discuss the results with the Lender to determine if the project make-up is causing improper scoring (locked doors or windows, or other characteristics unique to certain healthcare projects). ORCF will also flag the Borrower in HUD's Active Partners Performance System (APPS). The flag may adversely affect the Borrower's eligibility for participation in HUD programs, under HUD's Previous Participation Certification procedure, by constituting a standard for disapproval. All REAC Inspections receiving a score of 30 and below are automatically referred to the DEC for enforcement action.
  - a. **DEC Actions.** The DEC may arrange a conference call to discuss the inspection results with the Borrower and issue a Notice of Violation (NOV) demanding correction. Requirements of a Borrower that are included in the NOV include the following:
    - i. Conduct and submit a 100% survey identifying the physical deficiencies in the project;

- ii. Correct the physical deficiencies at the project including but not limited to those deficiencies identified in the REAC Inspection; and
- iii. Execute and provide a certification of corrections. Refer to: <http://portal.hud.gov/hudportal/documents/huddoc?id=10-04hsgnatt1.pdf>

The DEC may take additional enforcement action and seek any and all available remedies including to but not limited to, acceleration of the outstanding principal indebtedness, foreclosure, or any other appropriate remedies.

- b. **Follow-up and Monitoring.** In addition to mitigating EH&S items as described in A.4 of this chapter, Borrowers are responsible for correcting all deficiencies noted on physical inspection reports.

Borrowers are required to ensure a complete (100%) inspection of the project is performed. This follow up inspection shall include the site, all building exteriors, all building systems, all common areas, and all units. For clarification purposes: all areas within a building that are not residential units are considered common areas for inspection purposes. All deficiencies identified on a REAC Report must be corrected. To verify compliance, the Borrower must complete and sign the certification and provide it to their Lender and assigned - AE.

Lenders play a critical role in ensuring the Borrower has met their obligation to correct deficiencies and are encouraged to monitor progress and performance. Since the REAC Inspection is just a sample of the physical condition of the project, the 100% inspection of the project is important. Lenders should encourage the Borrower to, at a minimum, perform the following on an ongoing basis:

- i. Review of Exigent, Health, and Safety (EH&S) problems identified in the REAC physical inspection. These items should be considered a priority and should assure that all EH&S deficiencies have been and remain corrected.
- ii. Review of units and common areas to verify that significant REAC physical inspection report deficiencies (other than EH&S) such as falling retaining walls, broken sidewalks, exterior painting, etc. have been corrected

A Lender or HUD may decide to perform a site review of a project, to ensure deficiencies are addressed, should there be issues of concern with regard to the physical condition of the project.

Borrowers will be notified as subsequent REAC Inspections are scheduled by inspectors.

Any questions on REAC may be directed to the REAC Technical Assistance Center (TAC) at 1-888245-4860 or email at: [REAC\\_TAC@hud.gov](mailto:REAC_TAC@hud.gov)

- B. State Surveys.** As discussed in Section 3.5, part of the State inspection process includes a Life Safety Inspection. As this inspection focuses on the compliance with fire protection requirements, it may reflect concerns with the physical condition of the project as it impacts the residents. ORCF regularly reviews the Life Safety Inspection as well as the entire State Survey and Medicare Star Ratings, to determine if there may be issues pertaining to the physical condition of the project. For more information on Life Safety, State Surveys and Medicare Star Ratings, refer to Section 3.5.

### 3.7.3

## Resources for Addressing Physical Repairs and Improvements

- A. Reserve for Replacement.** As discussed in Section 3.2.2 of this chapter, a R4R escrow exists for all FHA-insured and HUD-held mortgages, in accordance with the Regulatory Agreement. The R4R is established to help defray costs of replacing a project capital items. The R4R is a possible source of funding considered to help meet costs to maintain the physical condition of the project, in addition to the operating budget. A Borrower should work with their Lender and AE to seek approval of withdrawals from the R4R to address capital improvements and repairs. For more information on R4R, refer to Asset Management, Chapter 4. Escrow Accounts.
- B. Other Resources.** As Borrowers are responsible for maintain the project's physical condition, the Borrower may propose other resources of funding to be utilized to address needed physical repairs or proposed for capital improvements. Examples such as Borrower provided funding (not project funds); surplus cash notes, residual receipts are all sources potentially contemplated to address physical repair needs. Any Borrower contemplating capital improvements with additional funding sources must always consult the Lender and ORCF to ensure Regulatory compliance, as described in 17.4.

### 3.7.4

## Physical Condition and Regulatory Compliance

Borrowers and operators execute Regulatory Agreements under ORCF's Section 232 Programs. Part of the regulatory requirements described in the Regulatory Agreement is to keep the project in decent, safe and sanitary condition and in good repair. During any period in which HUD insures the Loan or holds a security interest on the Mortgaged Project, it is a Regulatory Violation for an Borrower or Operator, without Lender's and HUD's express written consent, to proceed to impact the physical condition of the project in any of the following ways:

- A.** Make physical change, or permits changes to, the Mortgaged Project, whether negligently or intentionally, in a manner that reduces its value;



- B. Fail to maintain the Mortgaged Project in decent, safe, and sanitary condition and in good repair; or
- C. Materially fail to comply with covenants in the Note, the Borrower's Security Instrument, the Regulatory Agreement, or any of the Mortgage Insurance Documents respecting physical care, maintenance, construction, abandonment, demolition, or insurance against casualty of the Mortgaged Project.

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### **3.7.5**

### **Project Capital Needs Assessment**

The intent of the Project Capital Needs Assessment (PCNA) is to ensure the long term viability of the project and ensure the proper deposit to the R4R account. When required by the project's Regulatory Agreement, the existing PCNA must be updated every ten years. Updates to the PCNA must follow the Statement of Work as set forth in Production, Chapter 4, for a Limited Scope PCNA. Updated PCNAs must be submitted to the Project's AE every ten years, as required (unless required prior to that date due to other circumstances). The cost of each such PCNA may be requested for reimbursement from the R4R account.

## Section 3.8

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# Telecommunications Towers

### 3.8.1

#### Introduction

This section provides guidance for Borrowers regarding the procedures for requesting permission from ORCF to lease an area of the FHA-insured project for communication towers and/or other telecommunications equipment. A checklist of required exhibits to submit to HUD when requesting approval for communication towers and/or other telecommunications equipment is available on the Section 232 Program website.

### 3.8.2

#### General

ORCF supports Borrowers of FHA-insured projects leasing space for communication towers to telecommunication providers for the purpose of increasing revenue for the project. Pursuant to the Regulatory Agreement, the Borrower must submit the required documents to the assigned AE for processing prior to execution of the lease, as HUD approval is required for these types of commercial leases. The documents must also be submitted to the Lender for review and recommendation for approval, prior to HUD submission. A review of the documents will focus on issues regarding any effect on the project's income and expenses, the Regulatory Agreement and Security Instrument. HUD closing attorneys and HUD engineering staff may review the required documents and provisions prior to the AE making a final determination.

### 3.8.3

#### Requirements

- A. **Contracts:** In the proposals for telecommunication contracts, the providers typically intend installing all necessary equipment on the project site at no cost to the project, and in return, the project receives lease payments. ORCF is supportive of these arrangements, provided that they bring a higher level of service to our communities in a more competitive atmosphere, increase project revenues, and enhance project marketability, and further provided that any associated physical, business, and legal risk involved with installation and maintenance of such towers is appropriately mitigated. Additionally, a HUD environmental review may be required before HUD approves a contract or lease for telecommunications towers.
- B. **Engineered fall distance.** All structures shall be located outside the engineered fall distance of any support structure for high voltage transmission lines, radio antennae, satellite towers, cellular towers, etc., as discussed in Production, Chapter 7.5.K.2.

**C. Lease:** The following points are to be taken into consideration:

1. The lease may not be modified, extended or terminated without the prior written consent of the Lender.
2. The lease may not be modified or extended without the prior written consent of HUD.
3. The lease must be assignable by the Lessor to the Lender and/or HUD (i.e., upon foreclosure or deed-in-lieu of foreclosure).
4. The lease is subordinate to the HUD-held or FHA-insured Mortgage (Security Instrument).
5. The lease will not be automatically terminated by foreclosure or any other transfer of the mortgaged project; and, that in the case of foreclosure or deed-in-lieu of foreclosure, the Lender and/or HUD shall have the right to accept or terminate the lease.
6. The lease must contain a clause that states that the Lessee shall, upon receipt of notice of default under the Mortgage (Security Instrument), pay all rents payable under the lease to the Lender and/or HUD.
7. The lease must contain the following information:
  - a. a comprehensive list of the equipment to be installed, including a list of any proposed improvements to the FHA-insured project;
  - b. Lessee is responsible for the maintenance of the equipment;
  - c. maintenance schedule;
  - d. access information; and
  - e. where the equipment is located (i.e., roof) along with a drawing of the location.
8. The lease shall contain a provision which conditions approval of the lease on the Lessee obtaining all variances, permits, license or approvals required by applicable law.
9. The lease must contain a certification from the Lessee that it has performed its own investigation of the project and has determined its suitability for use.
10. The lease may contain a provision granting the Borrower, its successors and assigns the right to relocate any equipment, wiring or cabling.
11. The lease must contain a provision permitting the Borrower, its successors and assigns the right to terminate the lease should, 1) Lessee default in payments owed under the lease, 2) Lessee's authorized use of the premises materially interfere with Borrower's use and operation of the project and building, or, 3) it be determined that

the Lessee's equipment constitutes a danger to the health and safety of the project's residents or poses a danger to the structural integrity of the building.

12. The lease must contain a provision mandating that hazardous waste materials will not be stored, used, generated, etc., on or in the FHA-insured project at any time.
13. Anti-Deficiency Provision: in no event shall HUD be subject to an indemnification provision in the lease, whether in the present or future (if it becomes Lessor to the lease).

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## Section 3.9

### Commercial Space

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#### 3.9.1

#### Introduction

##### A. General Guidance

This section provides guidance pertaining to ORCF's requirements related to additions or alterations to commercial space on projects currently insured under any of the programs covered by this Handbook.

##### B. Categorization of Space.

Commercial space in a Healthcare Facility can be categorized as a space within the project that has been altered or converted for use other than residential purposes from which income is derived or anticipated. In accordance with **24 CFR 200.73**, a project may include such commercial and community facilities as the Commissioner deems acceptable. Commercial space differs from community space or community facilities. The term "community facilities" refers to project amenities, such as a pool, resident parking/parking garage, business center or fitness center that are predominantly used by residential tenants, with or without charging additional fees. Community facilities generally do not produce regular income and any intermittent revenue is to be included as ancillary income.

#### 3.9.2

#### Types of Commercial Space for Assisted Living, Intermediate Care, and Skilled Nursing Facilities

**Commercial Space vs. Community Space.** Generally speaking, due to the special nature of these types of projects, commercial space is to be limited to commercial activities that benefit the type of residents that live in the project. Unless the project has been constructed as a mixed use building, the project shall include commercial activities that are consistent with the type of project and type of residents served. Common Commercial Space areas in ALF, Intermediate Care Facilities (ICF), SNF and Board and Care Facilities include, but are not limited to: hair salons, convenience stores, specialized medical care provider spaces, ice cream parlors, coffee shops, gift shops and non-resident parking. These are deemed "commercial" instead of community spaces if they are income producing on a consistent basis and gain their revenue from residents and customers on a "pay for service" basis separate from the monthly bed charge. Residential parking, if a fee is charged to residents, is still considered community space and is recorded as ancillary income, not commercial income for the purpose of the calculations and limitations below.

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**3.9.3****Space and Income Limitations**

This section provides guidance pertaining to when a Borrower wishes to change the intended use of part of a project to commercial space.

- A. **Commercial Space and Income Limit Computations.** Commercial Space and Income is limited to 20 percent of the total gross floor area of the property and 20 percent of the Effective Gross Income of the project Commercial Space that is intended to exclusively serve the residents of the project is not counted toward the 20 percent limit.
- B. **Non-Compliance and Retroactive Approval.** There may be instances in which residential space is converted to commercial use without the knowledge of HUD. ORCF shall inform the project Borrower, in writing, that such action is in violation of the Regulatory Agreement and that failure to correct this violation may result in HUD exercising its rights under the Regulatory Agreement, including denial of future participation in HUD programs. ORCF may approve the conversion retroactively, in its determination, provided all requirements are met.
- C. **Parking.**
1. Parking income attributable to residential tenants is considered to be ancillary income and is not included in the limits contained in Section A, above. Commercial parking spaces reserved for use by motorists who are not project residents or are not parking to use the on-site commercial tenant's facilities, and the related non-tenant parking income, must be included in the Commercial Space and Income limitations. The income and space attributable to parking spaces reserved for non-residential or non-commercial tenants must be included in the limitations, based on applying the percentage of the total spaces that are reserved for non-tenant use. For existing projects that are to be acquired, refinanced or will undergo substantial rehabilitation, that provide parking for a monthly fee, the Lender must identify the percentage of monthly parkers who are non-tenants so as to include these in the commercial income limitations, above. The maximum occupancy factor to be applied to the parking income attributable to parkers who are not associated with either the project's residential or commercial tenants shall be the lower of:
    - a. The amount indicated by the market and by the historic performance of the subject, or
    - b. 50 percent.
  2. If the Borrower operates a parking facility that provides parking for residential or commercial tenants of the project, the Lender must determine parking income based on an analysis of the past 3 years of operation and the trailing 12 month period prior to application.
  3. If the parking facility is operated by a third-party, the Lender may use the amount of income collected under the contract if it is a fixed monthly payment. Parking

contracts that specify a percentage rent in addition to or in place of a fixed rent are not permitted without a waiver.

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### 3.9.4

## Submission Requirements and HUD Review

- A. **Submission Requirements.** Please see the list of exhibits listed on the checklist posted on the Section 232 Program website. The checklist discusses the logistics of the submission.
- B. **Processing.** The AE will notify the project Borrower/operator of any deficiencies in the package, and will notify the Borrower/operator and mortgagee promptly when a decision has been rendered.
- C. **Additional Considerations.** The following issues will be considered by ORCF in processing Commercial Leased Applications:
  - 1. Current Financial and Physical Condition of the Project.
  - 2. Open Federal, State, and local compliance Issues.
- D. **Decision on Request for Approval.** After consideration of the Borrower's request for approval and the materials submitted in connection with the request, the Asset Management Branch Chief or Senior AE must notify the Borrower and the mortgagee in writing of the approval or disapproval of the proposal and provide the reasons for such determination.



## Section 3.10

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# Special Circumstances Requiring the Notification of the Servicer and/or AE

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### 3.10.1

#### Introduction

Throughout this portion of this chapter there are indicators that require a Borrower and/or Operator either to notify the Servicer and the AE concurrently, or to notify only the Servicer (who would in turn elevate the matter to the AE as appropriate) of a Project's risk, of an action or improvement plan or of progress on previously reported situations. ORCF has created a sample format that Servicers may use in reporting this information; the sample may be found on the Section 232 Program website.

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### 3.10.2

#### Failure to Make Lease Payment

- A. The Servicer and AE must be immediately notified by the Borrower of a failure to make a Lease payment.
- B. The Servicer and AE will work with Borrower and Operator to understand the financial or business circumstances that have resulted in the non-payment, and try to facilitate an action plan that will remedy the non-payment status.
- C. The Servicer will continue to monitor the situation, to ensure timely payments continue in the future.
- D. Borrowers and Operators are strongly encouraged to work together with the Servicer to facilitate remedies to any problems with the Lease payments because the Servicer can be of assistance in such scenarios. If the Servicer knows of the payment status early enough, they may be able to work with the Project to create an action plan and remedies with the parties before any non-payment penalties are incurred.
- E. In the event of a non-payment related to a Borrower/Operator dispute or other non-financial reason, the Servicer must contact the AE to discuss the severity of the situation and whether it should be transferred to the Risk Mitigation Branch.

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**3.10.3****Default of Master Lease**

- A. Notification of Default of a Master lease must be provided from Borrower to Servicer and HUD within two (2) business days following the Borrower's receipt of the notification.
- B. Once notified, Servicer will evaluate other projects within the Master lease, to determine cash flows and the ability to cover the failing project(s). The Servicer will collaborate with HUD.
- C. Default on a Master lease will impact the Project, legal documents, and potentially a default on the mortgage. The project will be serviced by the Risk Mitigation Branch.

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**3.10.4****Special Focus Facility**

- A. Notifications to HUD and the mortgagee (Lender/Servicer) are required to be submitted within two (2) business days after the date of receipt of notice of a Special Facility Focus (SFF) designation from a state or federal regulatory agency, unless a longer time period is approved by HUD.

Failure by the Project to notify HUD and the Servicer of a SFF designation will be deemed a violation of federal regulation 24 CFR 232.1015 and may lead to the involvement of the HUD Departmental Enforcement Center (DEC).

- B. Though it is a mandatory responsibility of a project to notify the AE and the Servicer of their SFF status, all Section 232 Program Servicers are to monitor the CMS SFF status list no less than monthly, to determine if any projects in their portfolio have been added to the SFF list or had a status change while on the list. If discovered on the list, the Servicer is to immediately contact the Project and the AE.

The Special Focus Facility list may be found at the following web address:

<http://www.cms.gov/Medicare/Provider-Enrollment-and-Certification/CertificationandCompliance/downloads/sfflist.pdf>

- C. The Servicer and AE will work with the Operator (and, as applicable, the Borrower and Management Agent) to establish an action plan for being removed from the SFF list.
- D. The AE will reassign the project to the Risk Mitigation Branch for ongoing servicing.
- E. Each Project and situation is unique; some may show improvement and move off the SFF list faster than others. The Servicer and AE (Risk Mitigation Branch member) will work with the Project to establish an Action Plan.

- A. **Reporting Requirements.** Keeping the Lender and ORCF informed of problematic surveys and of any actions that could threaten the licensure or provider payments for a project is crucial, since such matters can threaten the viability of operations that are needed to meet operating expenses and make mortgage payments.
1. Except as limited in 3.10.5.A.2, HUD requires reporting when the Operator receives a notice, report, survey or other correspondence (regardless of form) from any governmental entity that includes any statement, finding or assertion that:
    - a. Operator (or any principal, officer, director or employee of Operator), any Management Agent, the Project, or any portion of the Project is or may be in violation of or default under any of the Permits and Approvals or any governmental requirements applicable to the operation of the Project, or
    - b. Any of the Permits and Approvals are to be terminated, limited in any way, or not renewed; or
    - c. Any civil money penalty (other than a de minimus amount) is being imposed with respect to the Project, or
    - d. Operator (or any principal, officer, director or employee of Operator), any Management Agent, the Project, or any portion of the Project is subject to any governmental investigation or inquiry involving fraud.
  2. Reporting is only required with relation to Licensed Nursing Facility surveys when a survey has any findings higher than a “G” level or any repetitive “G” level or higher findings from prior surveys (pursuant to CMS State Operations Manual, Chapter 7, as may hereafter be edited or updated, or any successor guidance). Repetitive is defined as “unresolved from the two most recent consecutive surveys or a repeat violation having the same citation number”.
  3. **Reporting Logistics.** Unless otherwise requested by HUD or the Lender:
    - a. The *initial* communication from the Operator pursuant to this Section shall be a notice by email to the Lender (not to HUD) describing the conduct cited, the scope and duration of remedy(ies) imposed, and the timelines for corrective actions (not the survey or other extensive communication itself). Such email shall be sent within two (2) business days of receipt of the notice, report, survey, or other correspondence from the governmental entity.
    - b. The *next* communication from the Operator shall be email notification to the Lender that the issue(s) have been addressed to the satisfaction of the issuing regulatory agency.
    - c. The Lender shall notify the AE immediately when a matter listed in Section 3.10.5.A.1 is reported by the Operator that is not expected to be readily resolved or poses an immediate threat to licensure or funding. If necessary, the Lender should work proactively with the operator to ensure the issue(s) are addressed to the satisfaction of the issuing regulatory agency. The Lender may use an optional reporting form made available by ORCF for reporting

these or other matters of concern regarding the financial or operational performance.

- B. The receipt by HUD and/or Lender of notices, reports, surveys, correspondence and other information shall not in any way impose any obligation or liability on HUD, Lender or their respective agents, representatives or designees to third parties to take (or refrain from taking) any action, and HUD, Lender and their respective agents, representatives and designees shall have no liability to third parties for any failure to act thereon or as a result thereof.
- C. Failure to notify the AE and the Servicer of such inspection reports, Plans of Correction, approval reports or other qualifying communications, will be a violation of federal regulation 24 CFR 232.1015, as well as the operator regulatory agreement, and may lead to the involvement of the HUD Departmental Enforcement Center (DEC).

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### **3.10.6**

### **Legal Judgments**

The Borrower and the Operator must each notify their Servicer within two (2) business days of receiving a legal judgment, penalty or fine against the Project, in excess of \$50,000.

- A. The ability to cover a judgment/penalty/fine will vary based on the size of the project, the available cash, etc. The Servicer will work with the Project to discuss reasons for the judgment and impacts on the financial status of the Project, notifying the AE of outcomes. The Operator must provide the Servicer with an action plan (seeking the Servicer's guidance, as necessary and appropriate), and must work with Servicer to analyze the impact of the judgment, providing information to the AE of the status, until financial stability is regained.
- B. Depending on the financial position of the Project and its ability to absorb the imposed judgment, it may require a change to "Potentially Troubled" status in the HUD system, by the AE.

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### **3.10.7**

### **Professional Liability Insurance**

- A. On an annual basis, the Servicer must verify that each Project has the required Professional Liability Insurance (PLI) coverage, as approved during the Project's underwriting.
  - 1. If coverage is less than required, then the Servicer must work directly with the Project to resolve the coverage deficiency.
  - 2. If the coverage deficiency is not readily resolved, then the Servicer must notify the AE.
  - 3. The AE will maintain the Project with a "Potentially Troubled" status in the HUD system and the Servicer will monitor it, until the coverage is adequately provided.

- B. The Project must notify their Servicer within two (2) business days of any filing of one million dollars (\$1,000,000) or greater PLI claim against the Project.
  - 1. The Borrower must review the circumstances of the claim, and provide the Servicer with analysis of financial, operational and/or healthcare impacts, and a plan of action to address such contingencies. The Servicer will involve the AE as they deem appropriate.
  - 2. Depending on the financial position of the Project and its ability to absorb any ramifications imposed by the claim, the filing may require a change to “Potentially Troubled” status in the HUD system, by the AE.

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### **3.10.8**

### **Fidelity Bond Coverage**

On an annual basis, the Servicer must verify that each Project has the required Fidelity Bond/Employee Dishonest coverage, as approved during the Project’s underwriting.

- A. The Fidelity Bond or coverage must name the Mortgagee and HUD as additional loss payees.
- B. If coverage amount is less than required (at least two months potential gross income receipts, as required at the time of HUD Project approval), then the Servicer must work directly with the Project to resolve the coverage deficiency.
- C. If the coverage deficiency is not readily resolved, then the Servicer must notify the AE.
- D. The AE will maintain the Project with a “Potentially Troubled” status in the HUD system and the Servicer will monitor it, until the coverage is adequately provided.

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### **3.10.9**

### **Notification of Termination of Insurance**

- A. A project cannot be uninsured in the Section 232 Program. The Project must notify their Servicer and AE within two (2) business days of its receiving notification of any termination of insurance.
- B. The Operator must provide the Servicer with an action plan (seeking the Servicer’s guidance, as necessary and appropriate), and must work with Servicer to resolve the circumstances surrounding the notification, providing information to the AE of the status, until resolution is reached.
- C. Termination of insurance or the formal notification of a potential termination of insurance will immediately warrant a change to “Troubled” status in the HUD system until the issue is resolved.

Failure to notify the AE and the Servicer of such notifications will be a violation of federal regulation 24 CFR 232.1015, and may lead to the involvement of the HUD Departmental Enforcement Center (DEC).

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### **3.10.10**

#### **Threat to Abandon Project**

- A. The Borrower must notify their Servicer within two (2) business days of any threat to abandon the Project, when initiated by the Borrower or Operator. This is separate from an inspection/ survey decertification.
- B. The Servicer must investigate the threat to abandon the project, and attempt to mediate a resolution. The Servicer must escalate the threat to the AE if it becomes more imminent and/or cannot be resolved quickly without HUD involvement.

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### **3.10.11**

#### **REAC Inspections**

- A. The Borrower must notify their Servicer within two (2) business days of receiving a REAC score of 30 or below or a second REAC inspection score below 60.
  - 1. A score of 30 and below creates an automatic REAC referral to the DEC and must be addressed immediately.
  - 2. A second score of below 60 will warrant a referral to the DEC and must be addressed immediately.
  - 3. The Servicer must assist the Project in determining if an appeal of the inspection score is appropriate, and provide assistance in preparing the appeal to REAC.

Appeals to REAC have extremely time-sensitive deadlines which must be met. Please reference the Physical Condition portion of this chapter for more details on the REAC appeals process.
  - 4. The Servicer must review the inspection report to ensure repetitive findings are being addressed and physical plant items are taken care of immediately.
- B. Depending on the significant finding levels and repetition of findings without appeals or justification, a change to “Potentially Troubled” status in the HUD system, by the AE, may be necessary. The Servicer and AE should discuss the circumstances prior to a status change.

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**3.10.12****Accounts Receivable Loans**

As further defined in the Production, Chapter 15 and Asset Management, Chapter 10:

- A. When a Project proposes to add or amend an Accounts Receivable (AR) loan, it must be reviewed with the same scrutiny that such a loan would be reviewed during the initial underwriting process. The Project must submit the required documentation to the Servicer, who will review the information for completeness and submit the request to HUD for the AE to process.
  - 1. A change in the AR loan status initiated due to extenuating circumstances that have adversely impacted the Project (rather than straightforward changes in business) should be evaluated by the Servicer and brought to AE's attention for particular scrutiny. If the AR loan change is a straightforward change in the loan, there would be less of a concern than the need for a new loan due to a change in provider payments or other financial burdens.
  - 2. Circumstances may trigger a "Potentially Troubled" or "Troubled" status in the HUD system, by the AE. The Servicer and AE should discuss the circumstances prior to a status change.
- B. The Project must notify their Servicer within two (2) business days of any notification of default on its Account Receivable (AR) loan.
  - 1. Default on an AR loan may be an indicator of potential default on the mortgage. Therefore, once notified, the Servicer must evaluate why the AR Loan has defaulted, reviewing cash flows and the ability to cover the failing loan, and work with the Project to create an action plan for moving the loan out of a default status.
  - 2. Default on an AR loan will trigger a "Potentially Troubled status in the HUD system, by the AE. The Servicer and AE should discuss the circumstances prior to a status change.
  - 3. The Servicer must collaborate with AE (and Risk Mitigation Branch, if assigned) as necessary until the remedies are put in place and the action plan has been fully implemented; and must monitor the Project closely to ensure financial and operational viability until it is able to return a Not Troubled status.

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**3.10.13****Unauthorized Distributions**

- A. The Borrower must notify their Servicer within two (2) business days of receiving a Notification of Unauthorized Distribution by the HUD Financial Assessment Subsystem (FASS).



1. The notification also includes a designated cure period which must be adhered to.
  2. This notification is sent automatically to the email the Project registered in the system when an unauthorized distribution has been determined by FASS, as well as to the AE. The AE must also immediately notify the Servicer of the violation.
  3. The Borrower and, where applicable, the Operator, must provide the Servicer with an action plan (seeking the Servicer's guidance, as necessary and appropriate), and must work with Servicer to ensure the cure period will be met to resolve the violation, and to further review the circumstances leading to the violation. The unauthorized distribution may be a sign of financial distress that needs to be closely monitored, and an action plan may need to be put in place to do so.
  4. The Servicer must notify the AE if there are extenuating circumstances that are preventing the immediate submission of the action plan, and provide the AE with the action plan expeditiously, and assure that the funds are repaid within the cure period.
- B. There are times when REAC/FASS findings trigger contact from the DEC directly to the Project. Although the AE is also copied on such the notification, and must notify the Servicer, the Borrower is responsible for notifying the Servicer within two (2) business days of receipt of a REAC/FASS notification from the DEC.

The Servicer will then work with the Project to cure the violation or devise an action plan to cure the finding(s), including the AE as appropriate, and communicating with the DEC during the process.

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### **3.10.14**

### **Bankruptcy**

- A. The Borrower and Operator must notify their Servicer within two (2) business days of any bankruptcy petition related to any of the Project participants who may file for bankruptcy (i.e. Borrower, Operator, or Management Agent).
- B. The Servicer must review the bankruptcy status and circumstances, and within two (2) business days of being notified by the Project, must provide the AE with the specifics of those circumstances, including, but not limited to: bankruptcy type, contact information of the participants and their respective legal counsels, the reason for petition, and whether the petition is voluntary or involuntary.
  1. A copy of the bankruptcy notice must also be provided to the AE at this time.
  2. Upon the initial notification of imminent bankruptcy, the AE will transfer the Project to the Risk Mitigation Branch.

- C. The Project must notify their Servicer of any imminent bankruptcy proceedings of which it is aware. The Servicer must notify the AE of the imminent bankruptcy within two (2) business days of such knowledge.
1. Until an FHA insurance claim is filed, HUD expects the Servicer to fully participate in the bankruptcy proceedings. Unless, and until, HUD intervenes in the proceedings, the Servicer is expected to guard HUD's interests and keep HUD fully informed as to the case's progress and major developments.
  2. The AE will assign the Project to the Risk Mitigation Branch.
  3. The Servicer should be reviewing the bankruptcy to ensure:
    - a. The nursing home license, certificate of need, and provider agreements remain with the project
    - b. Rights to the operator's account receivables ("AR") remain with the Project or are paid towards AR financing approved by HUD for the Project's benefit
    - c. Lease payments are sufficient to cover debt and R4R requirements
    - d. Compliance with all covenant remains intact
    - e. Mortgage and security instruments remain enforceable in accordance with their terms
    - f. All Regulatory Agreements pertaining to the Project remain in effect and the parties to these agreements are complying with the requirements contained therein.
    - g. All actions required of the Servicer under Mortgagee Letter 91-17.
- D. Particularly for Projects under a master lease, it will not be unusual for a Project to be involved in bankruptcy proceedings without there being a monetary default; however it is still necessary for the Servicer to work closely with the troubled Project, and other projects within the master lease, to ensure that the bankruptcy has as minimal an impact as possible on the other projects, and to avoid further financial disruption in the other projects.
- E. The Servicer must provide routine bankruptcy status updates to the assigned AE and/or their designee. The Servicer may also be responsible for working with the Risk Mitigation Branch, OGC, DEC and/or a Department of Justice (DOJ) legal team.

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### **3.10.15**

### **Delinquent Mortgage Payments**

- A. Delinquent mortgage payments are not only a violation of legal obligations by the Borrower, but are also a sign of financial distress for a Project and are to be closely monitored by the Servicer. The Borrower is required to notify the Servicer and the AE if the mortgage payment is delinquent as of the 16<sup>th</sup> of the month.
- B. The Multifamily Delinquency and Default Reporting (MDDR) System will notify the AE of a delinquency after the 16<sup>th</sup> of the month. The AE will reach out to the Servicer for a status of the delinquency and expectations of when the payment will be made.

- C. Upon notification of a delinquency, the Servicer must work with the Borrower (and Operator, if applicable) to ascertain the financial, operational and/or other circumstances leading to the non-payment, including, but not limited to evaluating the ability of the Borrower to pay the mortgage, any anticipation of payments to be made, the financial strength of the Borrower (and Operator), recent state survey results, extenuating circumstances and other concerns potentially leading to the delinquency.
- D. The Operator must provide the Servicer with an action plan (seeking the Servicer's guidance, as necessary and appropriate). The Servicer must then notify the AE of situation, and provide the AE with an action plan to remedy the delinquency.
- E. The Servicer and AE may also, at this time, request and review financial reports from the Project to determine an action plan.
- F. Once notified of the delinquency, if no action from the Borrower or Servicer has taken place by the end of the month, the AE will work directly with the Servicer and Borrower to escalate the action plan.
- G. If the delinquency has not proven to be a chronic occurrence or the Project is not in monetary default, it will need to be monitored by the Servicer, but may not warrant a change to "Potentially Troubled" status in the HUD system. However, if the Project is already in PT status, or if there is evidence of rolling default status, the AE will downgrade the HUD system status and increase the monitoring, in coordination with the Servicer.
- H. The Servicer will monitor any mortgage payment that is over 30 days delinquent until it is paid.
- I. Once a non-payment has aged between 45 to 60 days, and no evidence of payment is anticipated, the Servicer must again notify the AE and provide additional information regarding cash flow problems or other circumstances within the Project that have led to the delinquency.

At this stage, the project will be transferred to the ORCF Risk Mitigation Branch to escalate the HUD involvement with the Borrower (and Operator) in an effort to avoid default of the loan. The Project will also be changed to a "Troubled" status in the HUD system for ongoing monitoring until the financial status, and mortgage payments, return to a stable level.

- J. For systemic late fees and delinquencies, but not beyond 30 days, the Servicer may use discretion in involving the AE, but must notify HUD if this occurs more than 6 out of 12 months. These systemic delinquencies may not necessarily warrant transition to the Risk Mitigation Branch or indicate a "Troubled" project, but further evaluation will be required.